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THE ESPORTS GUIDEBOOK: CASE STUDIES, BEST PRACTICES, AND NAVIGATING A NEW INDUSTRY

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With over 30 years of industry expertise, IDG Consulting is the premier research firm specializing in the worldwide video game markets and provides a full range of consulting and advisory services to the consumer electronics and entertainment software industries. IDG Thought Piece - The Esports Guidebook: Case Studies, Best Practices, and Navigating a New Industry was written and compiled by IDG's team: Emilie Avera, Christina Kei, Tejinder Mangat, and Yoshio Osaki.

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EXECUTIVE SUMMARY

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- The esports market is one of the most exciting and quickly growing categories that gaming has seen in years
- Many parties are excited by the possibilities of esports because they compare its potential against that of established physical sports franchises
 - Regardless of where one falls on the question of whether esports is a “real” sport, there are certainly parallels to draw between esports and physical sports—but a critical part of finding success within esports will be in recognizing how the two categories are **different**
- In its current state, most of the revenue generated by esports goes into the pockets of game publishers
- In order for the esports market to mature, it will be necessary to:
 - Increase the revenue out-flow that reaches non-publisher stakeholders, such as team owners, players, and media companies, as well as...
 - Increase the revenue in-flow to esports from sponsors and advertisings by onboarding non-endemics



EXECUTIVE SUMMARY

- IDG believes esports will not necessarily follow the same path as physical sports in evolving from “Esports 1.0” to “Esports 2.0”
- The maturation of the esports market will require coordination and flexibility from publishers, team owners, players, leagues, media channels, etc.
- This thought piece analyzes:
 - How the esports market has reached its current state
 - What drives the market
 - What key players are doing to advance the market
 - What will be necessary for the market to evolve
 - Projections on what that future market may look like





**METHODOLOGY & THE
CHALLENGES OF
FORECASTING ESPORTS**

THE HYPE MACHINE IS COUNTERPRODUCTIVE

- While the introduction chapter, What Is Esports?, (appearing after this Methodology section), aims to clarify what esports is, and what it isn't, there remains a major discrepancy in the size, impact and perception of esports, when examining the thesis points of some analysts vis-à-vis the major publishers involved in this market
- While some analysts have published lofty numbers for the current and future size of the esports market, and while these optimistic projections add more attractiveness to the space, ultimately there are two bigger considerations:
 - In a private room when big decisions on esports are made, the executives will want to know the true size of the market, and not just what will feed into the hype machine
 - As a result of overly rosy projections, both internal and external, some companies are making some unwise decisions around esports based on numbers that might be higher than what the reality would indicate
 - In these early stages, it is more important, in IDG's view, to focus on the key drivers, risk factors, and business model structures surrounding the esports ecosystem. Through a deeper analysis of these components, publishers, esports teams, franchise owners, league organizations, media companies and other stakeholders can make more informed strategic decisions moving forward.



JUST HOW BIG IS THE ESPORTS MARKET?

- The esports market is undoubtedly one of the most intriguing and promising growth areas that the gaming industry has seen in recent memory
- The question everyone wants to know is... **“How big IS the esports market?”**
- To date, IDG has not published an official forecast on the size of the esports market, and will not for the near term, for one simple reason:

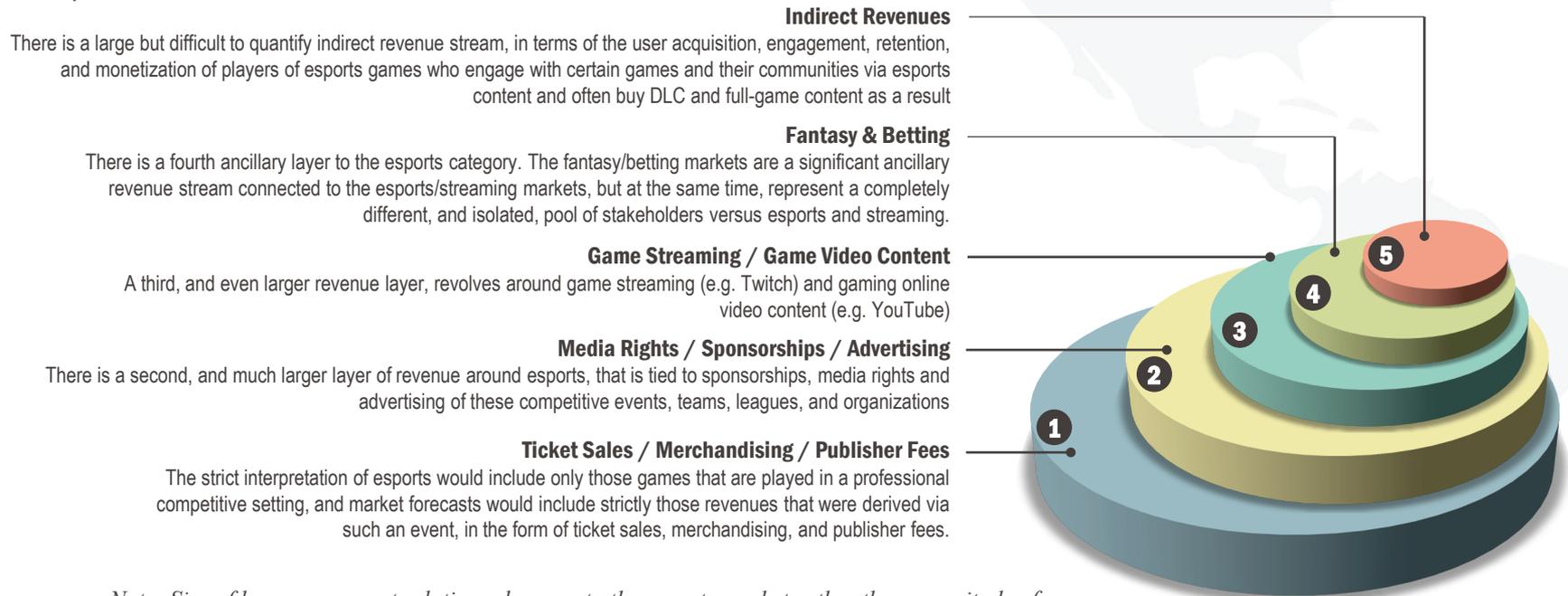
There are simply too many unknowns within esports to responsibly draw reasonable conclusions on the size of the market opportunity

- In the rest of this chapter, IDG will layout exactly what we DO NOT/CANNOT know about the esports market and why
- In the rest of this report, IDG will make its best effort to illuminate what we DO know about the esports market, the opportunity it presents and best practices in participating in the esports market



WISDOM OF THE CROWD DOES NOT APPLY

- As IDG has alluded to, there is still a lack of consensus around the true size of the esports market
- Beyond the difficulties in pinning down all of the revenue streams, dollar for dollar, the methodologies of disparate estimate sets are still somewhat obscure
- From a forecasting standpoint, there is also a wide array of perspectives on what should or should not be included in the esports umbrella



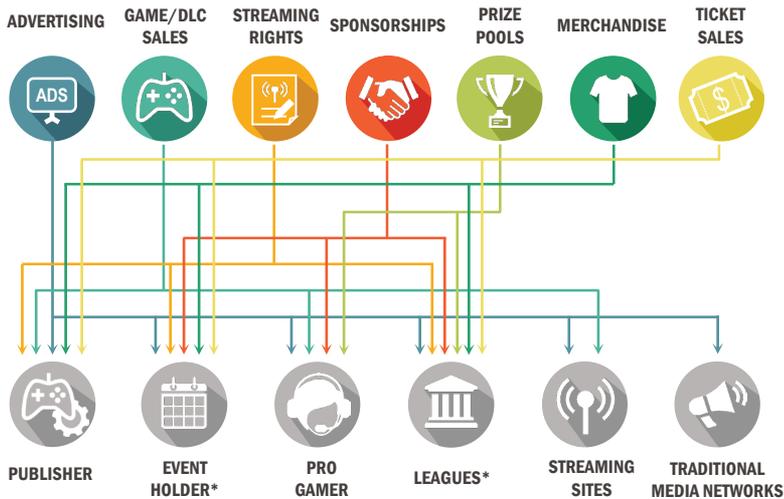
Note: Size of layers represent relative relevance to the esports market rather than magnitude of revenues



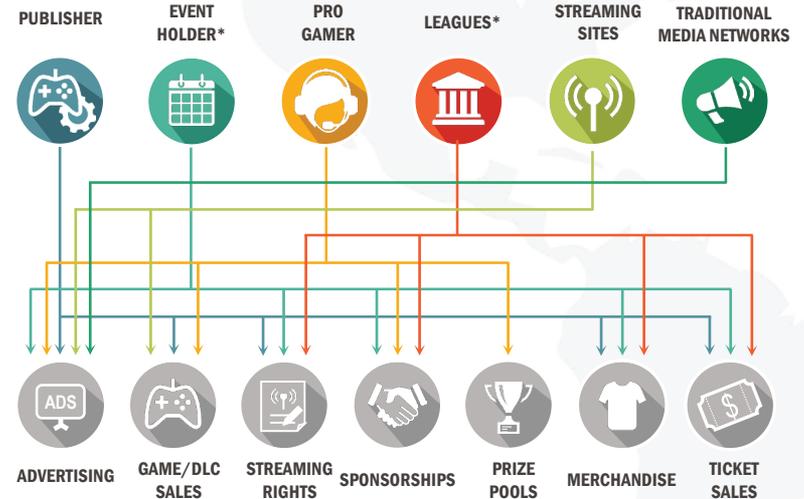
POTENTIAL FORECASTING METHODOLOGIES

When it comes to forecasting the esports/streaming market, IDG has researched two approaches—sizing the market by type of revenue stream as the first tier, and breaking down those categories by the various stakeholders as the second tier (if possible), or vice versa

BY REVENUE STREAM



BY STAKEHOLDER



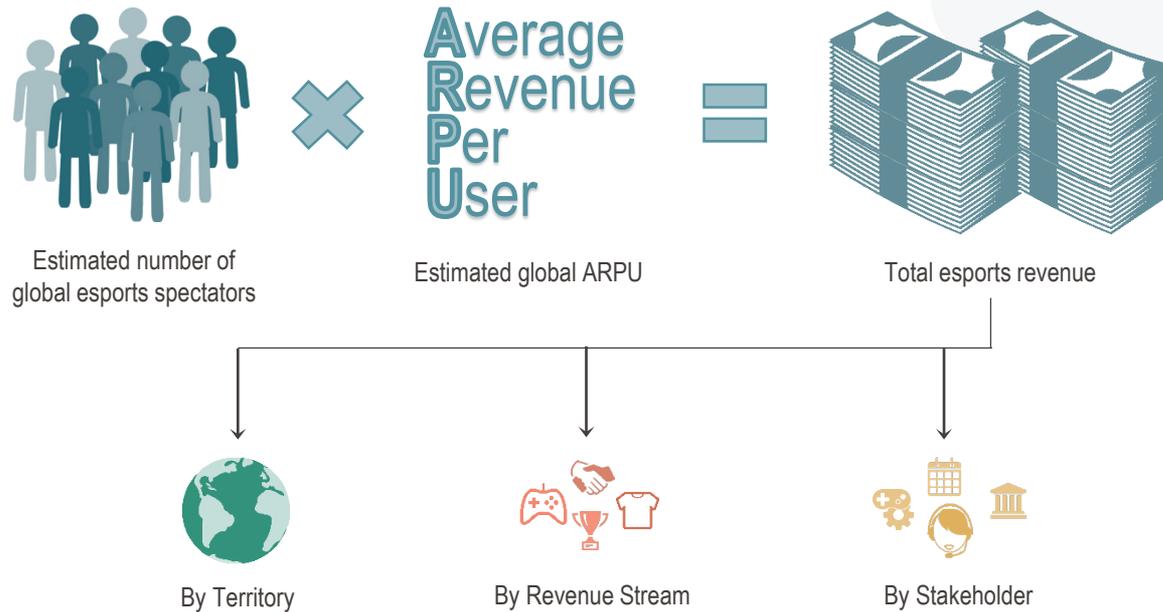
Both approaches present significant gaps in the assumption set that would be required to produce a reliable forecast—these are outlined in more detail on later slides

* Event Holder and League can often be the same party, but are not necessarily so



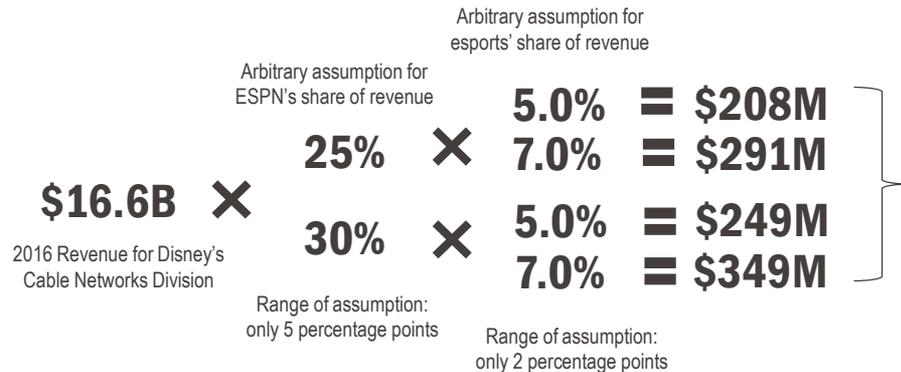
A THIRD POSSIBLE APPROACH TO FORECASTING

There is a third approach to sizing the esports market that is more feasible but, in IDG's opinion, significantly less accurate and therefore not as responsible an approach to forecasting—sizing the esports market by population and breaking the total revenue down into subcategories:



GENERAL PITFALLS TO FORECASTING ESPORTS

- Too many assumptions upon assumptions: Even when the range of each assumption is not especially large, the act of factoring in an assumption upon another figure that is also an assumption has the result of magnifying the range of the output manifold
 - Using advertising as an example, ESPN's esports channel could be derived thus:



From low end to high end, the range of the output spans **nearly \$150 million!** —and this is with fairly narrow ranges of assumptions of between 2-5 percentage points. With a market as opaque as esports, the range of assumptions could easily be in the 10-15 percentage point range.

- Add upon this figure, with a confidence interval of \$150M, numerous additional companies with similarly large confidence intervals, and the final output for the estimated revenue derived from esports advertising alone could have a final confidence interval in the billions. Factor in the other revenue streams within esports and the total esports revenue forecast could have a confidence interval in the **tens of billions!**



CAVEATS TO FORECASTING ESPORTS ADVERTISING

- Advertising is arguably one of the largest components of esports/streaming revenue, but also one of the most difficult to demarcate, as many of the esports stakeholders who generate ad revenue also generate non-esports ad revenue or non-ad esports revenue
- Stakeholders who generate esports/streaming ad revenue include traditional media networks, streaming channels, event holders, publishers, and in some rare cases, pro gamers
- There are many ways to estimate the ad revenue being generated in the esports/streaming market, with some of the more preferred methods outlined below:



- Clearly, none of these methods are ideal because, on top of resulting in estimates with generally low levels of confidence and high ranges of variance, these figures would then be summed across numerous stakeholders and multiplied by gross-up figures (of low-to-moderate confidence) to account for the rest of the market



ADDITIONAL AD SIZING CONSIDERATIONS

UNFORTUNATELY, IDG DOES NOT HAVE A BASIS AS TO HOW MUCH ADVERTISING ON ESPORTS EVENTS OR TOURNAMENTS COST, ESPECIALLY FOR HOW IT VARIES BASED ON EACH GAME'S POPULARITY

However, these advertising rates likely vary on different services like Twitch and Facebook Live and IDG does not have much edge on how much viewership different esports events reach

Ad monetization for gaming content on YouTube is also increasingly being tightened as advertisers are pressuring YouTube to avoid ads content featuring violence/hate speech

According to marketing firm Blue Corona, a typical video ad on YouTube runs between \$0.10 and \$0.30 per view



Marketing firm On Advertising claims that digital advertising rates are similar to traditional TV ad rates because the digital streaming market is already fairly mature

The rates for TV ads likely vary based on the popularity of the network and the event being shown. Though esports has made a major step into broadcast television on ESPN2 and TBS, this content has failed to penetrate mainstream networks like NBC, Fox, or CBS.

It is also unclear as to how many esports tournaments will make its way to traditional TV as the audience for this genre appears to be better reached through digital means in the first place



THE UNKNOWNNS OUTWEIGH THE KNOWNNS

- To be clear, IDG makes no pretenses to the fact that market forecasting, *by nature*, always involves a degree of conjecture, or to the fact that other IDG forecasts are by no means based entirely on known facts
- However, what makes the case of esports unique is the fact that the sheer number of unknown factors is at a completely different level, and IDG has a responsibility to its clients to NOT produce forecast figures when we do not have a reliable degree of confidence in our numbers
- It's the difference between speculating on what the true picture is, based on the two examples below:



One can reasonably assume
this is a picture of a globe



This (the same picture) could
literally be anything



A FINAL WORD ON MARKET FORECASTING

- In this report, IDG does indeed have a high-level estimate for the overall esports market size, but our team has yet to publish official estimate numbers at a bottoms-up level across each of the granular revenue streams. By reporting this way, IDG is avoiding the risk of providing the illusion of precision.
- In future esports reports, IDG may forecast esports at a more granular level if new data points and business norms become more concrete
- Despite these forecasting caveats, the rest of this report will focus on the areas of the market that we do have more color on, and the implications for both the present and the future of esports





INTRODUCTION

What Is Esports?

DEFINING ESPORTS

As IDG tackles one of the most intriguing research areas in the games industry, an integral question comes to mind:

What exactly *is* esports?

The answer might be less straightforward and more nuanced than some might realize. Esports is a lot of things. It is one of the **fastest-growing verticals** of all media and entertainment today. It represents a **unique nexus** that connects gaming, physical sports, gaming video content (GVC)/livestreaming, and fantasy/betting mechanics.

The purist's definition of esports would include only those games that are played in a professional competitive setting, and their market forecasts would include strictly those revenues that were derived via such an event, either through advertising, sponsorships, content licensing, etc.

However, the fact is that esports grew hand-in-hand with the advent of the **culture of game streaming**—one might say that streaming was the oxygen that esports needed to grow into the blazing hot market it is today. Moreover, the fantasy/betting markets are a significant ancillary revenue stream connected to the esports/streaming markets, but at the same time, represent a completely different, and isolated, pool of stakeholders versus esports/streaming.

Therefore, in this report, when IDG considers the esports opportunity, we look at both revenues derived from both the pure esports scene, as well as those derived from game streaming, while considering betting/fantasy as a secondary but critical offshoot of the first two categories.



WHAT MAKES AN ESPORT AN ESPORT?

A game that is entertaining to spectate, and better yet, sets an aspirational target for spectators



Easy to pick up and play, but extremely difficult to master (very high skill ceiling)

This includes being simple to spectate

Casual games are inherently incompatible, which is why mobile esports is having difficulty taking off



CATCH-22

The two golden rules of esports development contradict each other

Developers can't make a game an esports—**gamers** make it an esports

Yet a successful esports game in today's market, ideally, **MUST** be designed from the ground up to be an esports rather than having esports elements added to it after the fact. For example, a game with a compelling spectator mode will have higher likelihood of success.



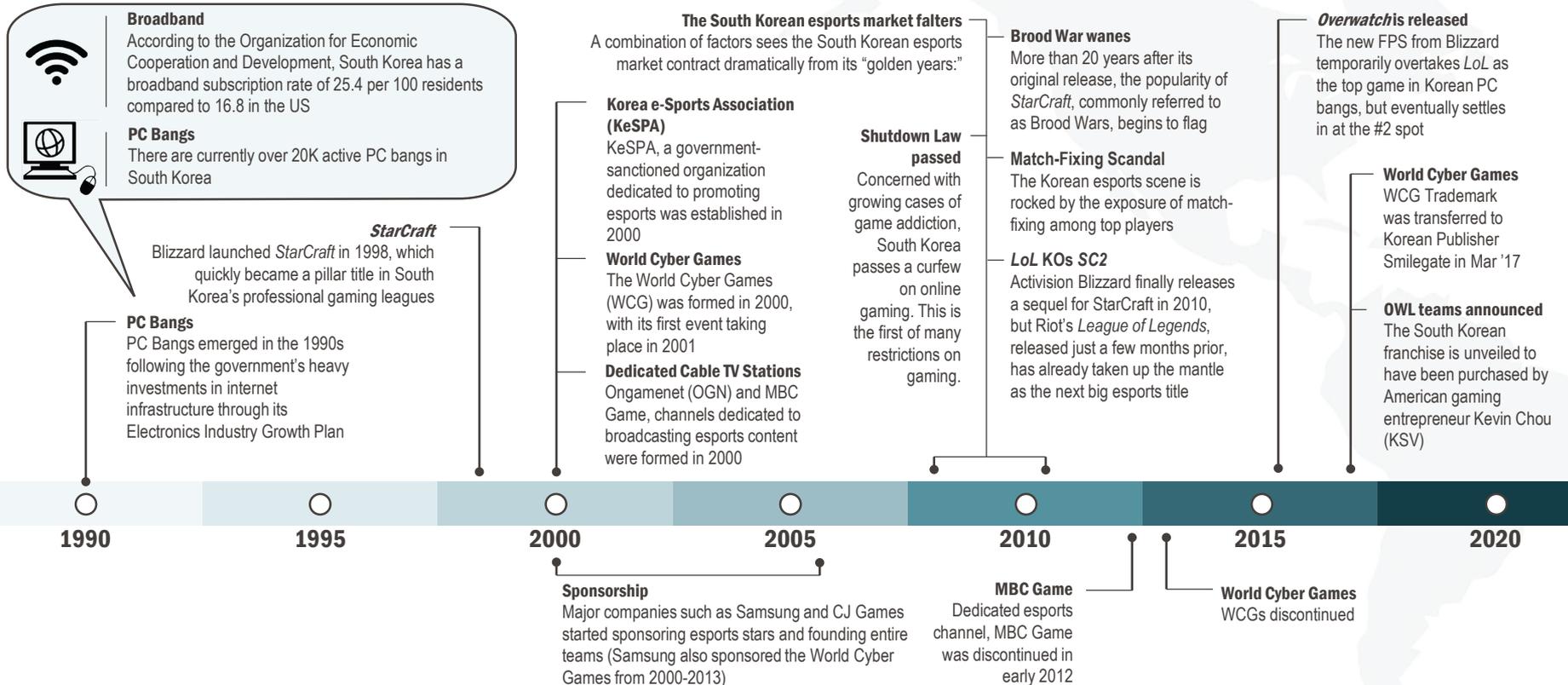
WHAT MAKES A GAME AN ESPORT?

THE WORLD OF ESPORTS:



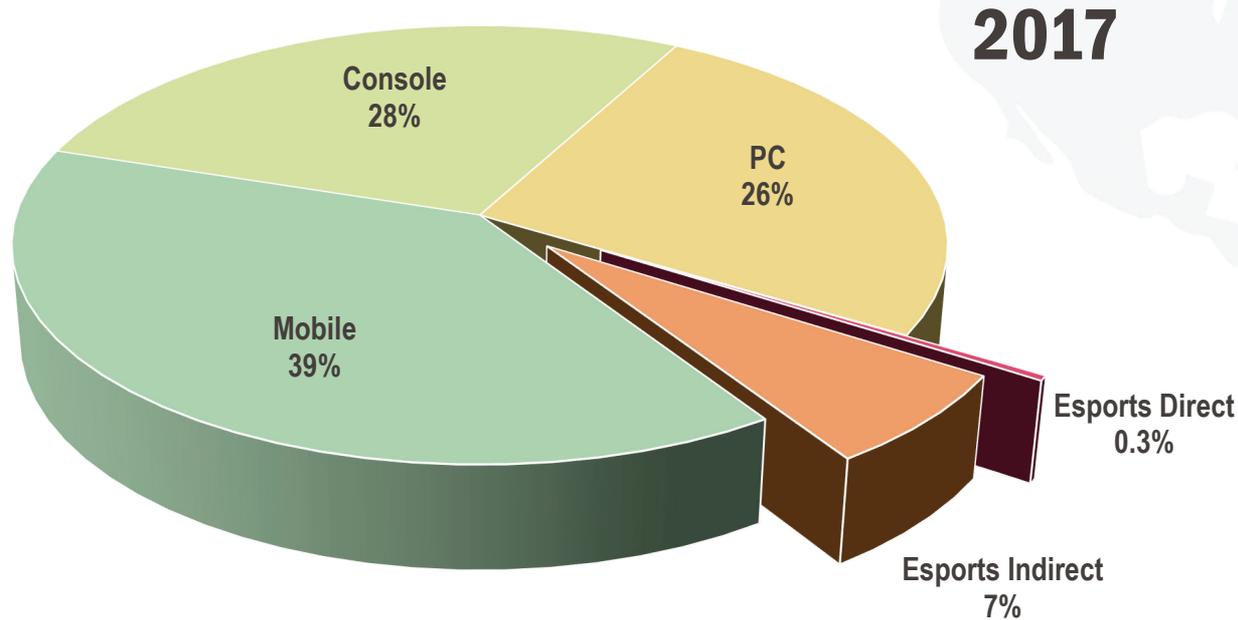
QUICK HISTORY OF ESPORTS IN SOUTH KOREA

Any proper historical account of esports starts in South Korea, the country where esports is already a “real” sport and has been considered one for decades



THE KEY CONTRADICTION ABOUT ESPORTS

Esports is filled with contradictions. While it is growing rapidly, it has yet to reach a critical mass of market share power within gaming, although that will change over time. When direct esports revenues are included in a vacuum (ticket sales, merchandising, sponsorships, etc.), they are a relatively minor piece of the puzzle. But when we add in the indirect revenue driven by esports in the form of improved player engagement, retention, DLC and full-game digital game sales, esports' contribution is much more material.

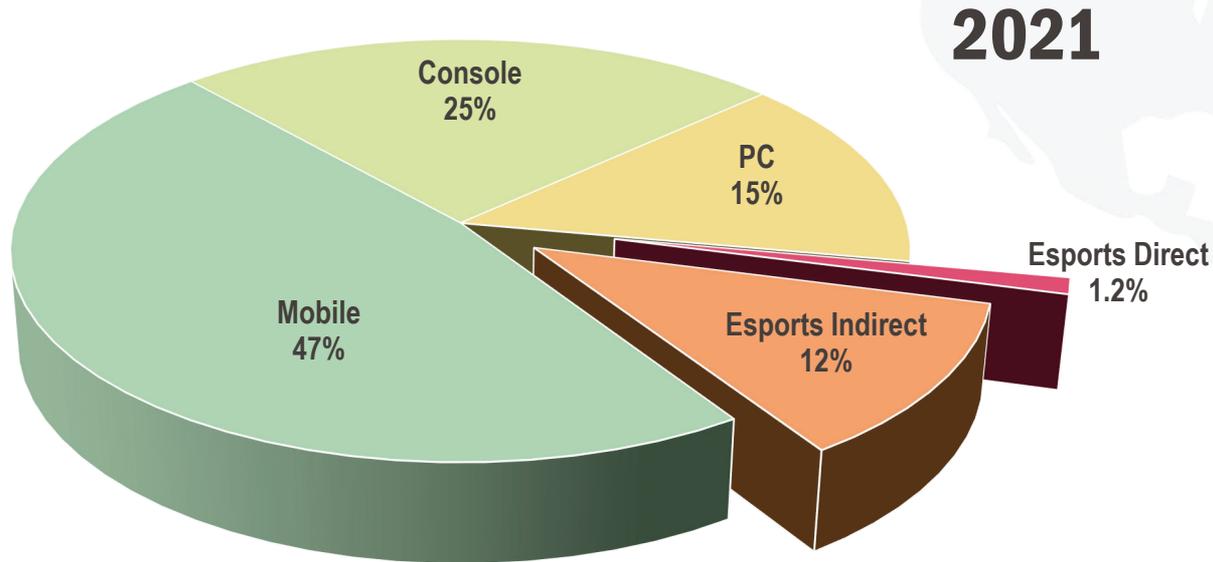


Source: IDG Estimates



BIGGER IMPACT BY 2021

IDG also believes that rapid growth for the esports category in the upcoming years will still render it a relatively small portion of the broader gaming market 5 years from now from a direct revenue standpoint. But when direct and indirect revenues are measured, esports clearly emerges as a material growth driver for the games industry.

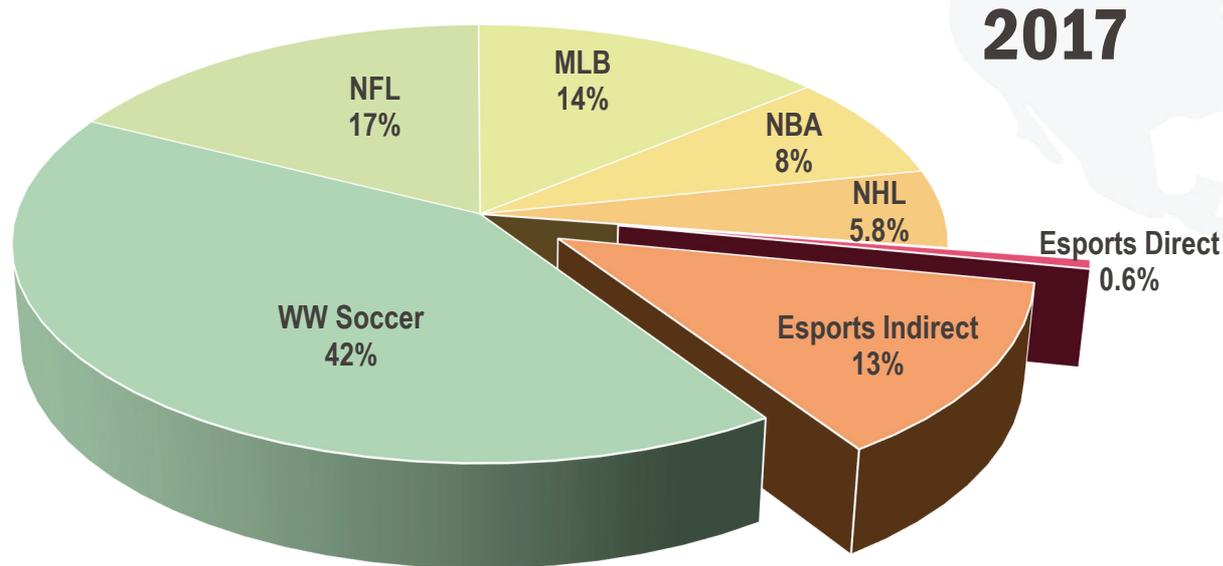


Source: IDG Estimates



ESPORTS VERSUS PHYSICAL SPORTS

When measured against the four major physical sports leagues (NFL, MLB, NBA and NHL) and worldwide soccer (La Liga, English Premier League, Major League Soccer, etc.), the esports market size is less than 1% of the physical sports total. When factoring in indirect revenue, however, esports becomes a more notable category.



Source: IDG Estimates



CAN ESPORTS BE CONSIDERED A “REAL” SPORT?

THE AFFIRMATIVE CASE: IT IS A REAL SPORT

Esports and physical sports have many critical similarities. Both have an emphasis on skills and ability, competition, the attempt at perfecting a craft, spectating, plus the thrill of victory and the agony of defeat.

The active shelf life of a cyberathlete follows a similarly short shelf life to that of many professional sports athletes, since both esports and physical sports rely on certain skill sets that can erode with age over time.

In football, baseball, basketball, soccer, and hockey, a myriad of different injuries can impede the longevity of a player's career, including knee, back, ankle, shoulder, and hand injuries. In the NFL, traumatic brain injuries from concussions are also a risk factor. And in swimming, which is not covered in the below data set, many professional swimmers peak at the tender age of 21.

While many observers would not necessarily think that esports are taxing on a cyberathlete's body, that perception could not be further from the truth. Hand cramps, finger weakness, carpal tunnel syndrome, other wrist-related injuries, numbness in the extremities, headaches, and severe eye strain are just several of the many ailments that can plague cyberathletes who are often playing and practicing their craft for over 12 hours per day. In more extreme cases, such as the *StarCraft 2* superstar “Mvp” (also known as Jung Jong Hyun), players experience severe spine issues which can lead to neck pain, plus shoulder and arm numbness, all of which can be debilitating to a cyberathlete.

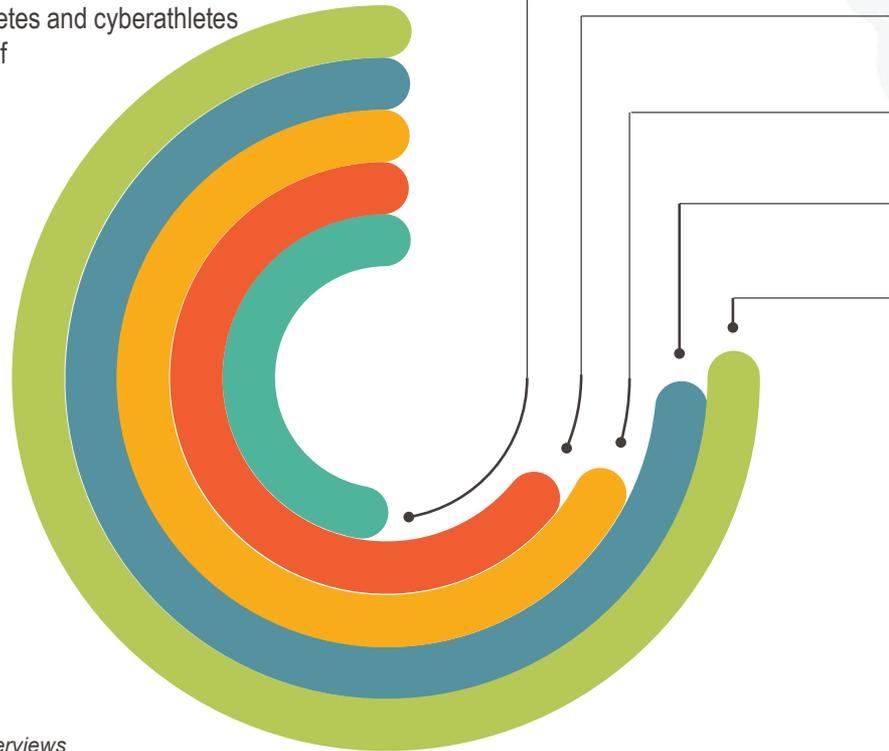
In terms of player performance peak in esports, many players reach their pinnacle in their early 20s, and retire by the age of 24. By age 24, most players start to see deterioration in their cognitive motor skills, which are crucial in driving reaction time that can make the millisecond difference between a win or a loss.



IS ESPORTS A “REAL” SPORT? (CONT'D)

AVERAGE PRO CAREER LENGTH

Physical sport athletes and cyberathletes share similarly brief career longevity



National Football League – 3.5 years



National Basketball Association – 4.8 years

Esports – 5.0 years



National Hockey League – 5.5 years



Major League Baseball – 5.6 years

Source: IDG analysis, stakeholder interviews



IS ESPORTS A “REAL” SPORT? (CONT’D)

THE NEGATIVE CASE: IT IS NOT A REAL SPORT

However, there are many observers who believe that esports is not a real sport, and this perception is also a critical barrier to broader acceptance and mainstreaming within society. The “recency” of esports cannot be underestimated. While the advent of major esports started in South Korea in the early 2000s, baseball was invented in 1839, soccer in 1863, football in 1869, hockey in 1875, and basketball in 1891. Even video games themselves reached mainstream status with the introduction of Atari’s *Pong* in 1972, roughly a century after the major physical sports had begun to enter the societal mainstream.

Categorically-speaking, esports in and of itself is not just one sport. If anything, the term esports is more of a “catch-all” phrase that captures multiple top-tier competitive games, each of which function as their own individual sport. For example, a championship cyberathlete in *League of Legends* may not necessarily have the right skill set to be equally competitive in *CS:GO*. And the best practices to be successful in *Street Fighter* are very different from the competitive differentiators in *Overwatch*.

In essence, the better analogy is to approach each individual top-tier competitive title as its own sport, in the same way that the NBA and NFL have very different and unique sets of athletes.



IS ESPORTS A “REAL” SPORT? (CONT'D)

PHYSICAL SPORTS

- From an advertising standpoint, most physical sports have built up their fan base and distributed their content primarily through traditional media channels, such as linear TV
- These sports, including the NFL (National Football League), NBA (National Basketball Association), MLB (Major League Baseball), NHL (National Hockey League), etc., focus first on traditional media channels and are now branching out to digital channels

#1 Traditional Media | Linear TV

#2 Digital Media | Streaming Websites
Online Channels



ESPORTS

- By contrast, esports represent the inverse of the approach that physical sports has taken, as content is distributed primarily through digital channels
- Only in recent years have esports become distributed via traditional channels such as linear TV to supplement the already-strong digital fan base

#1 Digital Media | Streaming Websites
Online Channels

#2 Traditional Media | Linear TV



LESSONS FROM THE PAST: POSTMORTEM ON CGS



Led by experienced media/entertainment/sports executives and owned/operated by DirecTV, the Championship Gaming Series (CGS) set out to legitimize esports and evangelize the masses to esports by creating a premier location-based professional esports league, signing exclusivity contracts with top players, and streaming games on mainstream media channels, raising the scene to the level of physical sports as well as other competitive games, such as poker. With over \$50 million in funding, CGS was extremely well-positioned to succeed, yet the company went under after just two seasons. There were several factors that led to the league's shutdown:



UNILATERALISM

Entering the grassroots esports scene as a well-funded powerhouse, CGS tried to mold the entire esports ecosystem the way it saw fit, without working with team owners or other leagues. In its bid for dominance, CGS ended up sucking the air out of not only their competitors but the entire esports ecosystem, making it impossible for CGS itself to survive.



POOR ROI

Many in the organization—from executives to managers to players—were reportedly highly overpaid in spite of lacking games industry experience. The higher financial expenditures shortened CGS's timeline to get things off the ground. And yet the huge upfront investment set up an expectation of great returns. CGS may have survived longer had it rationed its funds better for the long haul and its executives operated with a scrappier mindset.



THE WRONG GAME

CGS chose *Counter-Strike: Source* as its flagship game. At the time, the CS community was split between fans of *Counter-Strike: Source* and *Counter-Strike: 1.6*—and fans were passionate in favor of one game and against the other, so CGS was guaranteed some fallout no matter which game they chose.



THE WRONG EXECUTIVE TEAM

The CGS endeavor was primarily led by experts in the field of media, entertainment, sports and other industries. Only a few endemic esports experts were leveraged for their know-how.



THE WRONG FOCUS

CGS thought it could evangelize the masses by airing esports matches on mainstream TV, but in doing so, it overlooked esports' strongest supporters, who were viewing streams online instead



MISUNDERSTANDING THE USER

CGS failed to recognize how community-driven competitive gaming is, which led to business practices that were often inconsiderate of professional players



TOO EARLY

Possibly, the league's investments were too great for what esports was at the time.

Ultimately, it is unclear if CGS's internal problems were the root cause of its demise or if the audience for esports simply wasn't developed enough at that point in time.



ESPORTS INVESTMENTS TODAY

- When CGS shut down in late 2008, it left a large vacuum that made it difficult for the league's professional players to recover and steered investors away from esports overall
- It has only been in recent years that investors have once again become interested in esports with significant funding going into the space
 - While competitive gaming is on the rise and platforms are growing for professional players and leagues alike, funding for the scene needs to be diversified to make it a sustainable ecosystem
 - Revenue from sponsorships, ticket sales, merchandise, as well as DLC/Virtual Goods will be important for the scene's long-term success, but lofty investments with little strategy and high expectations for return could do more harm than good in the space at such an early stage
- Esports have had trouble attracting major sponsors from outside the games industry
 - There is a lack of knowledge amongst traditional marketers about major esports titles and who their demographic is
 - Scandals like player doping and viewership fraud can turn off major brands interested in getting involved in the space
 - These problems may be addressed with time, but it is unrealistic to expect a wide swath of major non-endemic brands to jump on the opportunity in the near-term





ESPORTS DRIVERS

IDG Insights

PUBLISHERS' FINANCIAL POV ON ESPORTS

- A layer of revenue that is related to esports but incredibly difficult to capture, is the game and DLC revenues that are indirectly driven by improved user and monetization metrics via esports
- Many of the leading publishers of the top esports titles have historically viewed their investment in esports via tournaments, event sponsorships and organization as a strict marketing expense, and as a “loss leader”
- In that spirit, it is difficult to calculate return on investment (ROI), since esports are being used to help nurture, improve, and grow the user community, but at the same time it is impossible to quantify the direct revenue impact of esports
- During our stakeholder interviews for this report, several industry insiders indicated that for some of these major games, there is already extremely high penetration, whereby the rate of growth of new users has decelerated significantly and most of the spend plus engagement in the game are from older users

Therefore, esports is being leveraged NOT as a driver of new users, but as a RE-ENGAGEMENT DRIVER to ensure stronger retention metrics, and to help monetize by driving awareness around new DLC, in-game microtransactions, loot crates, etc.



THE BEGINNINGS OF A POSITIVE ROI



While calculating a true ROI for publishers on esports marketing is virtually impossible, it is also universally accepted that the ROI, when calculating direct revenues only, has historically been negative for all of the publishers involved in esports

However, this trend is starting to shift, as publishers are moving away from using esports simply as a re-engagement driver for their user base, and instead some publishers are also monetizing esports by **selling lucrative streaming and broadcasting rights** for their IP within the esports realm



For example, Riot Games signed an exclusive online streaming deal with BAMTech for a minimum of

\$300 million

across a 7-year period



IDG channel checks also indicate the possibility of an even larger TV broadcasting rights deal between Riot and ESPN, potentially in the 9-figure range across a multi-year horizon. This is still merely speculative, however.



COUNTERPOINT: TEAMS' PERSPECTIVES

- While game publishers are starting to reap the benefits of esports, many professional teams and players are still struggling to get by
 - Though prize pools for major tournaments have been ever-increasing, non-championship teams often struggle with feast or famine earnings
- H2K, a *League of Legends* team in Riot's European League Championship Series (LCS), recently called for Riot to set better terms for subsidies and revenue sharing, noting that most teams aren't profitable while the publisher reaps huge rewards from game/DLC revenue, sponsorship, advertising, and streaming rights
 - H2K's management noted that their losses have exceeded €1 million per year
- Though changes in Europe have yet to be seen, Riot is improving the situation for North American teams starting in the 2018 season with the introduction of revenue sharing, stronger requirements for relegation, and the establishment of a Player's Association

Publishers are ultimately responsible for ensuring that the financials are mutually beneficial for the professional teams and players involved with their esports' leagues, in order for the leagues to become sustainable ecosystems

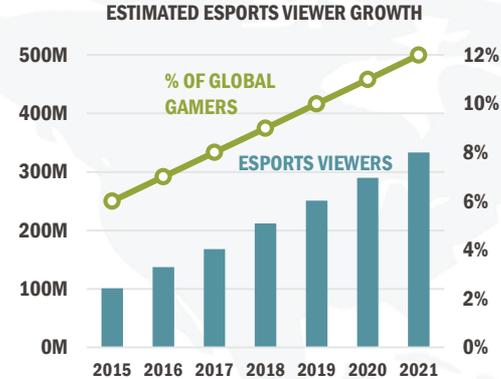


ASSESSING ESPORTS VIEWERSHIP



While non-gamers have a difficult time understanding the appeal of spectating other people playing games, this behavior has been an integral part of gaming from its early origins. At the arcade and in the living room, a favorite gaming pastime has been friends and family huddled around somebody playing a game.

The sophistication of the digital distribution infrastructure, via ecosystems such as Twitch, YouTube, Azubu, Smashcast, and Facebook Live, among others, has enabled this spectating behavior to scale in an impressively viral fashion



IDG believes that one of the key reasons for growth in esports is the significant growth of the addressable audience

Source: IDG estimates

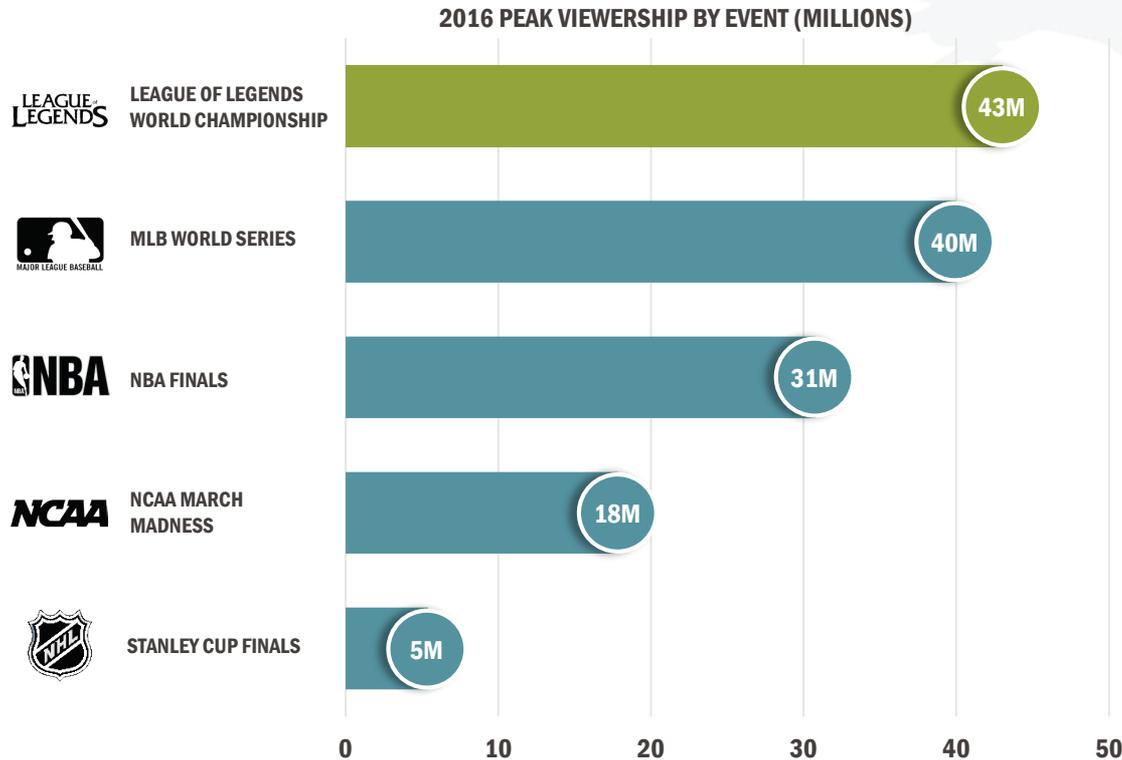


During certain esports tournaments, the Twitch site has logged over

2 million
people simultaneously



ASSESSING ESPORTS VIEWERSHIP (CONT'D)



- Esports event viewership cannot be compared perfectly apples-to-apples versus physical sports events for a couple of reasons:
 - Streaming online has a different addressable audience versus physical sports, which predominantly broadcast via linear TV
 - Esports viewership usually encompasses a global audience, while the sports metric in the graph to the left account only for the US audience
- Nevertheless, recent esports tournaments have shown viewership metrics that stack up well against those of physical sports events



WORD OF CAUTION RE: VIEWERSHIP FRAUD

- Streaming sites like Twitch and YouTube can provide analytics for performance of video game content viewership, but issues of fraud remain a challenge to accurately size streaming audiences
- **Viewbotting**, the act of using bots to artificially inflate viewership counts for web video content, is a problem for sites like Twitch
 - Companies providing viewbotting services have developed sophisticated methods to make the false viewership figures harder to detect, like using fake profiles that post chat messages and creating follower accounts in different regions of the world
 - Streamers use these services to temporarily boost their channel's ranks, improving their visibility for real users which in turn can lead to real followers and donations
- While Twitch is taking steps and legal action to block bots, the sheer amount of content streamed on the platform will make it difficult to prevent all of this fraudulent activity
- Companies interested in getting involved with streamers or esports at large should take this into consideration when trying to measure their impact on real streaming audiences



WHY ESPORTS ADVERTISING APPEALS

- The target demographic for esports is one of the most attractive yet elusive segments for today's advertisers—Gen Z and millennial age groups with significant buying power
- Females, who generally spend more than their male counterparts, are still a smaller proportion of the esports audience but are growing at a significant pace. IDG channel checks indicate that the female share is somewhere between 20-30%, representing a major increase versus earlier years.
- Advertisers have struggled to keep up with the content demands of these younger audiences, because this particular population continues to forgo cable television in favor of streaming services and therefore cannot be reached through traditional TV commercials
- What's more, research suggests millennials in Western markets are not as interested in spectating live physical sports events as their older counterparts, which is cause for concern for advertisers trying to reach this audience through traditional broadcasting as live physical sports is one of the few genres that have been thought to be immune to the Netflix effect
- Another strong benefit to reaching the esports audience through advertising is, the esports audience is **primarily online**, providing opportunities to better track/study their behavior for targeted marketing campaigns
- However, some non-endemic brands are still reticent to get involved as they are concerned about association with violent content in gaming, especially in FPS games

IDG believes that growth in esports viewership and engagement figures will prove the value of esports to advertisers that want to reach this coveted demographic. Meanwhile, it may take a game like Rocket League, which has mass market appeal and minimal violence, to finally draw in advertisers en masse to test the power of esports advertising.



ADVERTISING BEST PRACTICES

- Brands and companies that are used to more traditional modes of advertising need to innovate to effectively reach esports viewers, because this audience consumes media differently than the physical sports viewing audience, and to treat both audiences as the same would be a grave misstep
- Advertisers must leverage the fact that esports spectators are primarily a digital audience, and as such there is more data available on esports viewers and their interests
 - Facebook profile information and other web tracking/user profile tools can be used to gauge brand loyalty and engagement
 - Traditional TV advertisements for gaming typically target the 18-34 year old male demographic, but this fails to capture groups like women that digital advertising can more effectively target
 - Digital advertising also allows for creative ad campaigns to be tailored and personalized to best play toward the interests of these different user groups
- One of the things that makes the esports demographic a different breed than traditional TV-watching viewers is the level of interactivity that exists between players and spectators. Advertisers who cannot effectively adapt and leverage this quality to their advantage may not reap as many rewards as those who can.



ADVERTISING BEST PRACTICES (CONT'D)

- Advertisers must also redefine success in this new realm
 - Instead of just locking in on 1 or 2 key metrics, it is important for advertisers to focus on the collective aggregate of user engagement metrics, as the objective needs to revolve more around branding
 - Brand engagement must encompass an omni-channel approach across streaming, mobile, web, social media and TV, and across different KPIs such as page views, unique visitors, peak concurrent users, etc.
- Ad-blocking software and the sheer wealth of content available can still make reaching an addressable audience challenging, but other avenues are still available
 - Brands can leverage partnerships with established gaming channels and livestreamers to better promote services and merchandise as their audience has grown to trust these influencers



THE COMPLEX DYNAMICS OF SPONSORSHIPS

- Sponsorships have been a relatively nascent segment of esports but have been growing into a significant revenue stream
 - The early pool of esports sponsors have primarily included companies that have some skin in the esports game, such as endemic tech firms Logitech and Nvidia as well as sports clubs
 - However, there is **an ever-growing number of non-endemic sponsors**, or brands outside of gaming, like Mountain Dew, Xfinity and Audi joining their ranks
- Sponsorship deals for esports are currently **more affordable than in the physical sports market**, so there's first-mover advantage for brands who lock in multi-year contracts early
 - Turner's ELEAGUE confirmed that they were maintaining their \$2 million cost for their CS:GO league sponsorships in 2017, about the same as years prior
- As with advertising, one of the benefits of sponsoring esports over physical sports is that there is a greater amount of online activity that can be tracked and studied for improved target marketing
- At the same time, sponsors want to be affiliated with the most successful, winning esports teams. But in most esports leagues, there is often a lack of long-term stability as player movement from one season to the next persists at a rapid pace, with many players preferring to stick with shorter-term 1-year deals. As a result, some potential sponsors are also keeping their sponsorship deals with esports teams within a more limited, shorter-term time horizon to mitigate the risk of sponsoring a team that might be good this season but could lose key players and be worse in the following season.

Sponsorship deals will likely grow and become more important within esports over time. In the interim however, there will be some growing pains and likely volatility until a consensus forms around standard best practices between sponsors, esports teams, players and leagues.



ESPORTS AS A GAMES/DLC SALES CATALYST

- Why do publishers such as Riot, Valve, Blizzard, and many others spend so much money on esports economics if the ROI is not always 100% clear? Historically, the answer has been tied to the fact that esports is a formidable marketing and user engagement driver, indirectly helping publishers to sell more games and DLC content, as well as promote user engagement within those games.
- As a result, the sale of games/DLC that is driven by esports is one of the most enticing opportunities within the esports and streaming ecosystem
 - However, the value can be difficult to quantify for many publishers, as there is only a small segment of game/DLC sales that can be directly tied to an esports event or streaming video
 - Esports-specific DLC packs, click-through rate tracking through livestreaming partnerships, and Twitch's new integrated game purchasing API are all helping with this, but these likely only account for a small portion of the sales driven by the broader streaming and esports ecosystem
- Yet to not credit a certain proportion of sales to the culture of esports/streaming would be remiss, particularly for titles synonymous with esports such as *League of Legends*, *Dota 2*, and *Overwatch*
- Streaming and esports help to **boost visibility and re-engagement for a game** and its community, as it gives players an outlet to continue to be exposed to the games they love to play

Beyond the indirect revenue generation from esports as a marketing driver, IDG expects to see an increasing catalog of team- and tournament-specific DLC, such as player customization packs with team logos or virtual badges/trophies that allow users to display which tournaments they've attended. This type of monetization will add another high-margin digital revenue layer to the esports mix.



ASSESSING STREAMING PARTNERSHIPS

- Stephen Ellis, Facebook's Strategic Partnership Manager, said that **esports represents about 14-31% of all live gaming viewership across streaming platforms**
- With the growing strength of this type of viewership, the event-driven nature of esports tournaments, as well as the improving two-way interaction between streamers and spectators in building a stronger community and brand engagement vehicle, it is no wonder that a number of noteworthy deals involving the streaming rights of esports franchises have recently made headlines:
 - Riot Games granted exclusive streaming rights for *League of Legends* to BAMTech, a deal valued at a minimum of \$300 million
 - Twitch acquired the streaming rights for 20 different Blizzard tournaments in 2018 across *Heroes of the Storm*, *StarCraft II*, *Hearthstone*, *World of Warcraft*, and *Overwatch*
 - Facebook partnered with ESL to livestream all major ESL events and bring exclusive CS:GO content to Facebook's video platforms
- These streaming companies are in an arms race to develop exclusive content for their audiences and see esports as an opportunity to achieve viewership growth. While this contest will likely not approach Netflix-type levels at the outset, every esports-related platform will remain hungry for differentiated content in the years to come.

IDG expects competition for esports content on streaming platforms to persist as Twitch, YouTube Gaming, Facebook, and Mixer have made clear commitments to the space



THE UTILITY OF BROADCAST PARTNERSHIPS

- Traditional broadcast networks are also pushing into esports because they view it as an **opportunity to reach younger demographics** that are cord-cutting more and more
 - ESPN had previously broadcasted The International and Heroes of the Dorm on their secondary network ESPN2, but pushed further into esports when they broadcasted a *FIFA 17* Ultimate Team Championship event on their main network at the same time as the Super Bowl
 - Turner Broadcasting produced its own CS:GO championship series, ELEAGUE, and broadcasted it on the company's own TBS network as well as Twitch
 - NBC Sports recently partnered with Psyonix to broadcast the *Rocket League* Grand Finals as well, noting that the game's accessibility made it a good fit for NBC's current sports audience
- Representatives from these networks have said ratings for esports content have met expectations, but **it is unclear if esports on television will remain attractive** for them or tournament organizers
 - Turner's Craig Barry noted that narrative-driven content had stronger ratings than live events and that TBS wasn't trying to bring hardcore fans to esports, but rather act as a portal to educate casual audiences
 - After two years on ESPN, Blizzard shifted its broadcast for Heroes of the Dorm 2017 entirely to Facebook's platform as they felt they could better engage with their audience via streaming

Ultimately, IDG believes the future of esports will be digital, as the way in which esports fans consume content in the digital age is simply different versus older generations



HURDLES FOR TRADITIONAL MEDIA

- Ultimately, however, IDG believes traditional media will have a difficult time carving out a place within the esports ecosystem, and perhaps may not be able to find a large and permanent niche, for several reasons:
 - Aside from the fact that esports fans are cord cutters, each major title within esports has a unique community with its own quirks and preferences. This level of nuance is something that larger corporations may have difficulty navigating.
 - Aside from streams, many major esports brands already run their own channels with customized content produced around the clock. While their level of production and pizzazz may not rival what larger cable networks can produce, their in-depth expertise is more likely to satisfy the desires of the most committed fans.



FANTASY AND BETTING

- Last year, the Washington State Gambling Commission accused Valve of facilitating gambling after several third-party sites were discovered to be taking bets on CS:GO tournaments using highly-valued weapon skin virtual goods
 - **Most leagues and publishers don't sanction esports gambling**, but the scandal brought to light the murky world in which esports fantasy/betting currently takes place
 - There are a plethora of gambling sites with limited oversight and sometimes don't directly use money, so it would be virtually impossible to know how much money is actually involved
- However, **gambling laws are starting to open up for esports** and this may one day drive tournament organizers to accept gambling revenue as legitimate income
 - The state of Nevada passed legislation in May 2017 that extends state laws on sports betting to esports events, allowing Las Vegas casinos to take bets on esports tournaments
 - The Luxor Hotel and Casino announced plans to debut the first permanent esports arena on the Las Vegas Strip, which could offer an attractive venue for league organizers to host esports events and take a cut of any gambling revenue generated by the casino
- Another key theme to monitor is the emergence of cryptocurrency, which in some ways holds similarities with in-game virtual currencies. IDG anticipates a potential scenario whereby a secondary virtual goods market around fantasy/betting mechanics could emerge, with cryptocurrency functioning as the conduit.





PHYSICAL SPORTS AS A GUIDE FOR ESPORTS

Fact or Fallacy?

A CAUTIONARY NOTE ON PHYSICAL SPORTS

It is logical for many analysts and industry observers to compare esports to physical sports because of the key similarities (many of which are highlighted in the Introduction to Esports chapter)

One key similarity is, just as the fanbase for physical sports varies by the sport, so does the fanbase for esports vary by title. Not all fans of esports follow every title available, and the community for each title possesses unique qualities.



One area that IDG will try to steer clear of, however, is the comparison between the revenue mix for physical sports teams versus esports teams

While the former is instructive for the purposes of this report, it is still far too early to make any definitive conclusions around the actual size and projected growth of esports teams and leagues at the business model level

Since esports shares some key similarities with physical sports, and because many of the early pioneers in esports are hoping that it can reach the same business heights of physical sports, there is a temptation to assume that esports will follow the same growth path that physical sports have

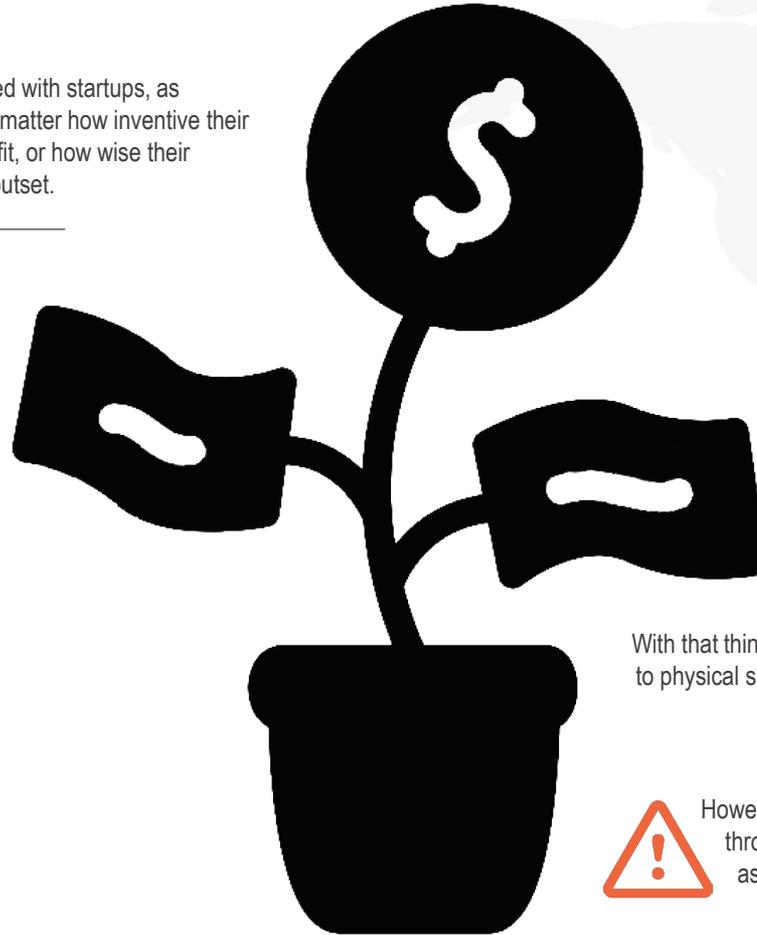
The reality will likely be much more nuanced than that. Esports will likely evolve in certain ways that will resemble physical sports, but at the same time, there are fundamental differences between esports and physical sports, all of which will ensure that esports will likely follow its own differentiated path, somewhat separate from that of physical sports.



ESPORTS : SPORTS :: STARTUPS : MATURE STAGE

Fragility and uncertainty are two traits associated with startups, as counterintuitive as that sounds. All startups, no matter how inventive their business model, how great the product-market fit, or how wise their founding management team, are fragile at the outset.

Observers might look at startups that made it big, such as Facebook, Uber, or Airbnb, as slam dunks that were obviously guaranteed to succeed. However, in the early stages of each of these companies, there were discrete inflection points that helped to determine if the startup would grow to reach success, or not.



In the same vein, esports is still in its relative infancy, and while the growth prospects look extremely bright, it is still too early to predict exactly how big this market will become, and the path through which it will get there.

With that thinking in mind, it is equally unwise to compare esports to physical sports, in the same way that it is unwise to compare a startup to the standards of a mature-stage company



However, the following pages will examine esports through the relative prism of physical sports, simply as a learning tool to better understand esports' potential



WHERE DOES ESPORTS FIT INTO THE BROADER SCHEME?

PHYSICAL SPORTS



In IDG's opinion, esports is **not exactly like a physical sports business**, and it is also **not exactly like a physical gaming business**

In essence, esports represents something that is in between these two

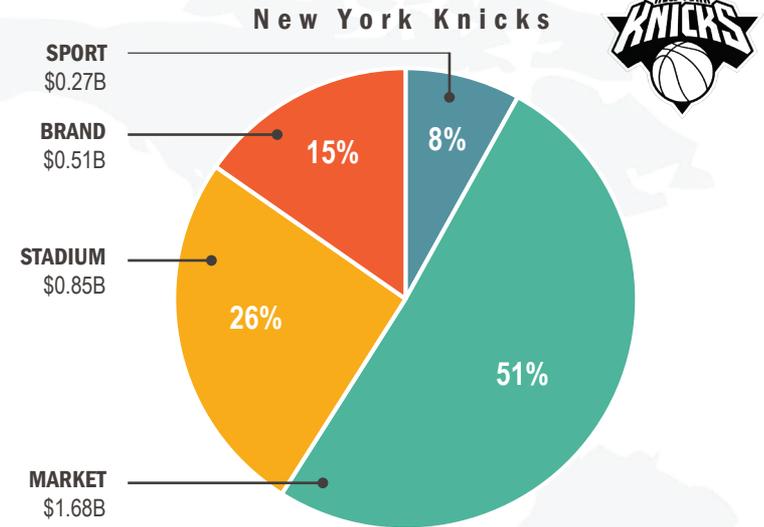
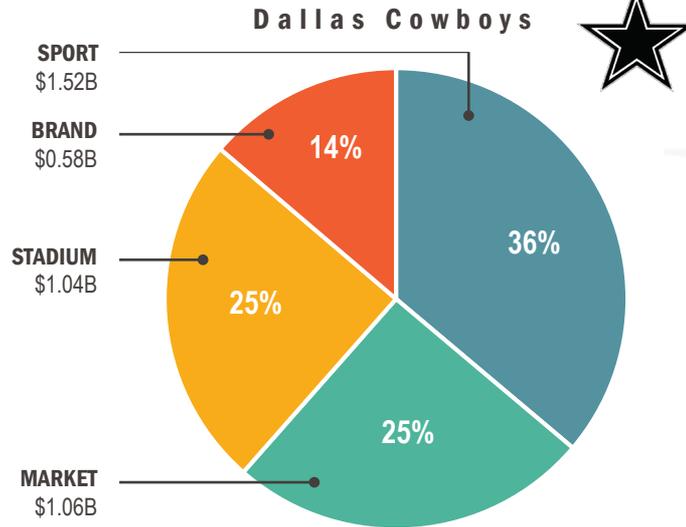


PHYSICAL GAMING

The goal is to identify the key best practices that will enable esports to grow into a much more sustainable, professional business with significant global growth over the next 5-10 years



THE ECONOMICS OF PHYSICAL SPORTS TEAMS



- According to Forbes, the most valuable franchises for the NFL and the NBA are the Dallas Cowboys and New York Knicks, respectively
- Revenue categories are defined as follows:
 - ▶ Sport Revenue - Portion of franchise's value attributable to revenue shared among all teams
 - ▶ Market Revenue - Portion of franchise's value attributable to its city and market size
 - ▶ Stadium Revenue - Portion of franchise's value attributable to its arena, which includes ticket and event sales.
 - ▶ Brand Revenue - Portion of franchise's value attributable to its brand. This includes merchandise.



GREEN BAY PACKERS FINANCIALS



The Green Bay Packers, one of American Football's best franchises, also holds the distinction of being the only major professional sports organization that is a public company

Local residents of Green Bay, Wisconsin are the primary shareholders of the company's stock, and through this arrangement, IDG has access to the Packers financials

The following tables lay out some of the key financial data points for the Packers, for illustrative purposes within this section

	FY2016	FY2017
REVENUE	\$408.7M	\$441.4M
National	\$222.6M	\$244.0M
Local	\$186.2M	\$197.4M
OPERATING EXPENSES	\$333.7M	\$376.0M
Player Costs	\$165.7M	\$192.5M
Team	\$43.3M	\$47.7M
Sales & Marketing	\$51.8M	\$56.6M
Operations & Maintenance, Net	\$27.2M	\$30.0M
General & Administrative	\$45.7M	\$49.2M
PROFIT FROM OPERATIONS	\$75.0M	\$65.4M
NET INCOME	\$48.9M	\$72.8M

	2014	2015	2016	2017
REVENUE	\$327.9M	\$377.2M	\$408.7M	\$441.4M
Y/Y Growth		15%	8%	8%
EXPENSES	\$299.3M	\$337.8M	\$333.7M	\$376.0M
Y/Y Growth		13%	-1%	13%
OPERATING PROFIT	\$28.6M	\$39.4M	\$75.0M	\$65.3M
Y/Y Growth		38%	90%	-13%
NET INCOME			\$48.9M	\$72.8M
OPERATING MARGIN	9%	10%	18%	15%



THE P&L OF AN ESPORTS TEAM

	LOW	MID	HIGH
REVENUE	\$0.87M	\$2.625M	\$5.05M
Live Streaming (esports and gaming lifestyle, 24/7)	\$250K	\$600K	\$1.0M
Sponsorships	\$500K	\$1.25M	\$2.5M
Appearance / League fees	\$50K	\$100K	\$200K
Merchandise Sales	\$20K	\$50K	\$100K
Tickets / Concessions / Merchandise	-	\$25K	\$50K
Revenue Share from League	-	\$500K	\$1.0M
Prize Pool (Team's Share)	\$50K	\$100K	\$200K
COSTS	\$1.50M	\$2.85M	\$4.20M
Costs of Services	\$1.0M	\$2.0M	\$3.0M
SG&A	\$500K	\$850K	\$1.2M

These figures are hypothetical future figures, as no teams currently receive revenue share yet from leagues or merchandise/ticket sales.



NOTE

These estimates of low-mid-high are not uniform for teams across all line items within a given level. In other words, the low-mid-high category for a single team would vary across every line item. Therefore, it would not be correct to sum all the revenue and costs in the a given column.



COMPARING PHYSICAL VS. ESPORTS

- While the Packers generated over \$400M in revenue in FY2016 and almost \$450M in FY2017, most sports analysts indicate that the Packers are not even in the Top 10 for the most valuable teams in the NFL. The Dallas Cowboys, the most valuable NFL club, is valued at \$4.2B, according to Forbes.
- Even then, the revenue that the Packers generate each year is still roughly 120x higher than some of the strongest esports teams, which generate on average annual revenues of \$1-5M in a solid business case scenario
- While esports teams will continue to grow in scale and size, and eventually start to fill the gap versus physical sports teams, there are a variety of headwinds that must be noted in comparing esports versus physical sports



ESPORTS' DEFICIENCIES VS. PHYSICAL SPORTS

STREAMING RIGHTS FEES ARE MUCH LOWER THAN TV BROADCASTING RIGHTS FEES



LEAGUE OF LEGENDS AUDIENCE IS DIFFERENT FROM PHYSICAL SPORTS AUDIENCE

Although a *League of Legends* world championship event garners more streaming viewers than a major physical sports event garners during a TV broadcast, the viewers are not apples-to-apples



STREAMING RIGHTS ARE NOT AS LUCRATIVE AS TV BROADCASTING

For advertisers and content networks alike, streaming rights have yet to garner the type of financially lucrative stratospheres that TV broadcasting rights have fetched for physical sports leagues



THE VALUATION OF STREAMING RIGHTS STILL HAS A LONG WAY BEFORE IT ACHIEVES THE SAME LEVELS AS BROADCASTING RIGHTS

As more sponsors and advertisers pour more money into the esports ecosystem, and in turn drive more advertising dollars into the pockets of esports distribution channels such as Twitch, the valuation of streaming rights should increase over time. However, IDG believes that esports has a long way to go before reaching the same types of payouts on streaming rights as physical sports have reached on broadcasting rights.



ADVERTISERS AND SPONSORS WILL NEED TIME TO LEARN HOW BEST TO PARTNER WITH ESPORTS TEAMS

For many physical sports teams, broadcasting/media rights are the most lucrative revenue streams for them, and it became more lucrative once advertisers and sponsors learned how best to partner with these sports teams. It will take at least several years before these traditional advertisers and sponsors learn how to adjust to esports, since they are also bridging the divide between analog and digital skill sets.



ESPORTS' DEFICIENCIES VS. SPORTS (CONT'D)

LESS STRUCTURED COLLEGE AND "FARM" SYSTEM FOR PLAYER SOURCING



COLLEGE TEAM STRUCTURES ARE LESS COMMONPLACE IN ESPORTS THAN PHYSICAL SPORTS

In physical sports leagues, there are a wide variety of minor leagues for up-and-comers to develop their skills until they are ready for the majors. College physical sports are also a huge feeder into the overall professional sports system, and are also lucrative TV viewership drivers. By contrast in esports, at least in North America where college physical sports are massive, most esports such as *League of Legends* are only beginning to cultivate a materially-important college team structure, and it is still in early stages. College systems are also challenged by the fact that many cyberathletes retire by the age of 24, soon after college is over.



IDG IS SKEPTICAL THAT ESPORTS CAN GENERATE THE SAME ENTHUSIASM AS PHYSICAL SPORTS FOR MINOR LEAGUE TEAMS

And with regard to minor league options such as The Challenger Series for *LoL*, which has since pivoted to being called The Academy, the interest on the viewer/consumer side has not been strong enough to foster long-term stability. For minor league teams in physical sports, while it is difficult to maintain financial stability in many cases, these minor league teams invest heavily in establishing a strong grassroots relationship with the local people in the city/town that the minor league resides in. There is also a concerted effort to target smaller towns that do not have a major league sports team presence. IDG is skeptical that a minor league esports team could foster the same type of small town-based affinity that minor league physical sports teams can, where the local citizens rally around their minor league clubs, go to games, spend money on merchandise, etc.



PASSION CAN BE HARDER TO ACHIEVE DIGITALLY VERSUS PHYSICALLY

The digital handshake is indeed different from a physical one in this case



CULTIVATING YOUNG TALENT IN ESPORTS COULD BE DIFFICULT IN SOME US CITIES

While it is likely that sourcing the next great pro gamers will be an advantage in places like South Korea, there might be US cities where the lack of a strong "farm" system will make it more difficult to acquire and cultivate great young talent for the major league versions of city-based organizations



ESPORTS' DEFICIENCIES VS. SPORTS (CONT'D)

ESPORTS PLAYERS ARE STILL FOCUSED ON SHORTER-TERM CONTRACTS, WHICH HINDERS LONGEVITY AND STABILITY, WHILE PHYSICAL SPORTS PLAYERS OFTEN PREFER TO SIGN LONGER-TERM CONTRACTS



SHORTER-TERM CONTRACTS ARE MORE COMMONPLACE IN ESPORTS VERSUS PHYSICAL SPORTS

In physical sports, most athletes prefer to sign longer-term contracts with their teams, to ensure greater financial stability, compensation in case of premature injury, and to foster two-way loyalty between the player and his/her team.

By contrast, esports is still in a more nascent stage in which many pro gamers prefer to sign shorter-term, 1-year contracts with their teams. This is due to the overreliance on prize pool money, which means that all players want to play for the best teams, without any guarantee that a specific team will have long-term success.



PLAYERS TEND TO SHUFFLE AROUND MORE OFTEN IN ESPORTS

From one year to the next, there is a lot of player movement from team to team, and until player compensations are more directly tied to stable salaries and benefits as opposed to prize pools, many pro gamers will choose to sign shorter-term contracts in order to have the option of leaving a team to find a better team if performance shifts occur



ESPORTS' DEFICIENCIES VS. SPORTS (CONT'D)

WITH VOLATILE PLAYER MOVEMENT IN ESPORTS, THERE IS LESS LONG-TERM STABILITY AND VIABILITY FOR TEAM SUCCESS, WHICH ALSO HINDERS THE COMMITMENT LEVELS OF ADVERTISERS AND SPONSORS



LONG-TERM DYNASTIES ARE MORE COMMON IN PHYSICAL SPORTS

As a result of rapid player movement, the odds of multi-year winning success in esports is very low at the moment. While dynasties in physical sports are also elusive, there are indeed examples of such dynasties in every major sport. For example, the New England Patriots in the NFL have had a strong track record over the past 15 years. The Chicago Bulls during the 1990s, as well as the Los Angeles Lakers and Boston Celtics (of the NBA), have all had multi-year track records of strong success. And in baseball, the New York Yankees have been a perennial contender every year, as management/ownership has been willing to spend a lot of money on the best talent.



LONG-TERM TRACK RECORDS AREN'T CUSTOMARY IN ESPORTS

By contrast, for the reasons mentioned in the prior slide, it is more difficult to foster a longer-term winning track record and culture in esports. This can change over time, but in the interim, it will also make it harder for sponsors to be involved on longer-term deals with teams if it is difficult to ensure that a particular team will enjoy long-term winning success.



STEPS HAVE BEEN TAKEN BY THE NA LCS AND OWL TO ENSURE LONGER-TERM STABILITY

The ending of the promotion relegation system in NA LCS, and the increasing focus on structuring a higher buy-in with serious, experienced and committed team owners in OWL and LCS are steps in the right direction to ensure longer-term commitment and financial stability.



ESPORTS' DEFICIENCIES VS. SPORTS (CONT'D)

MERCHANDISING SCALE AND TEAM BRANDING ARE HINDERED BY LACK OF LONG-TERM VIABILITY AT THE TITLE LEVEL



IN AN IDEAL SCENARIO, ONE ESPORTS TEAM WOULD EMERGE AS THE TOP TEAM

In the long-term, there is an optimal best case scenario whereby one of the major esports teams (Team Dignitas, Cloud9, KSV, etc.) becomes the esports version of the Dallas Cowboys (highest-valued team in American football) or Manchester United (highest-valued team in international soccer).

If we assume that winning is the key ingredient in the branding and merchandising success of a team, then this type of scenario could be possible if esports grows exponentially in the next several years and one team emerges as the perennial top team across one or multiple esports.



HOWEVER, PLAYER MOVEMENT RENDERS THAT SCENARIO UNLIKELY

However, IDG's concern in this area is not about individual team performance, even though it will likely be very rare for one team to remain dominant in an esports for a sustained period of time due to player movement (as highlighted in the previous slide)



WHILE PHYSICAL SPORTS HAVE BEEN AROUND FOR A LONG TIME, THERE IS NO GUARANTEE THAT ESPORTS BRANDS WILL HAVE THE SAME LASTING POWER

The bigger issue is that physical sports have been around for such a long time, and there is no risk that any of these established major sports (soccer, football, basketball, baseball, etc.) will ever leave the mainstream.

By contrast, it is possible that some of the esports that are popular today will lose popularity down the line, which could then lead to displacement for esports teams/franchises, players, and leagues through no fault of their own.



COUNTER-STRIKE HAS STOOD THE TEST OF TIME

One potential counterpoint to this thesis is the evolution of Counter-Strike, where it has morphed from one game and brand to a collection of several games with different gameplay mechanics, with *Counter-Strike: GO's* spectating elements propelling the title into a viable esports in recent years



ESPORTS' DEFICIENCIES VS. SPORTS (CONT'D)

ACCESSIBILITY'S STRENGTH IS OFFSET BY ASPIRATION'S WEAKNESS



WATCHING ESPORTS GENERALLY LEADS TO GREATER PLAYER ENGAGEMENT THAN DOES WATCHING PHYSICAL SPORTS

One of the great strengths of esports versus physical sports is its accessibility. Many viewers who watch games on Twitch are looking for pointers, new moves, or strategic tips. In fact, Deloitte reported that when it comes to gaming content videos, video reviews of games or instructional videos geared toward improving a player's skill are more frequently watched than streams of elite players. Immediately after viewing a livestream, many of these same viewers pick up their own controllers and start playing.

- Rather than an aspirational relationship between the viewer and pro gamers, there is more of an accessible relationship. Pro gamers often make themselves available to fans in a more intimate way than physical sports icons, thanks in large part to social media. Pro gamers will do more interactive live chat sessions with fans, and are all very active online.
- More importantly, many viewers of games are viewing because it then incentivizes them to play the game themselves
- This reinforces the strength of the games' user ecosystems, but actually hurts esports from a physical marketing standpoint



PHYSICAL SPORTS STARS TEND TO BE MORE REVERED THAN ESPORTS PRO GAMERS

By contrast, one of the major reasons why Michael Jordan, Babe Ruth, Tom Brady, or Serena Williams are revered is because they perform athletic feats that normal people cannot fathom, and applies to less than 1% of the population

- The aura of that super-human success translates to better marketing and branding deals for the athletes, since the only way for consumers to have access to this premium branding is through buying merchandise
- In the esports world, there is less of a pedestal that pro gamers are placed onto vis-à-vis physical athletes
- This also presents a challenge to media networks and content creators within esports, since narrative-based programming has always been a hallmark of physical sports. Narrative-based programming will be just as important in esports, but it might be more difficult to create compelling storylines around esports players vis-à-vis the idols of physical sports that have a loftier backdrop from which to create narratives.



ESPORTS' ADVANTAGES VS. PHYSICAL SPORTS

HOWEVER, THERE ARE SPECIFIC AREAS WHERE ESPORTS ACTUALLY HOLDS AN ADVANTAGE OVER PHYSICAL SPORTS, ESPECIALLY AS WE LOOK TOWARD THE FUTURE

STREAMING CONTENT ALIGNS MORE WITH CURRENT AND FUTURE CONTENT CONSUMPTION TRENDS THAN LINEAR TV VIEWING



THE RISE OF ESPORTS HAS BEEN ROOTED IN THE DEVELOPMENT OF STREAMING SERVICES

Esports' rise to fame has been driven in large part by the growth of Twitch, YouTube Gaming, and other streaming/UGC platforms



ESPORTS DEMOGRAPHICS GRAVITATE TOWARDS STREAMING CONTENT

Millennials and Gen Z users are often known to eschew physical content consumption patterns such as linear TV and box office theatrical, and instead choose to consume their content over the Internet across a wide variety of form factors



LINEAR TV VIEWING HAS DROPPED WHILE STREAMING METRICS HAVE CLIMBED

While TV ratings for the NFL have gone down significantly in recent years, the streaming metrics across the major esports have grown massively. Therefore, while the streaming market is still much smaller versus linear TV, streaming is a true growth driver while linear TV models might represent more of the past.



WHILE LINEAR TV IS THE MAIN CONTENT DISTRIBUTION VEHICLE FOR PHYSICAL SPORTS, IT IS USED AS A SECONDARY CHANNEL FOR ESPORTS

Esports is aligning with this future, whereas physical sports are still overly aligned with the past and if anything, we are seeing more digital streaming rights deals being done across the physical sports landscape since digital is becoming more important. At the same time, esports is diversifying into linear TV as a secondary channel to reach casual audiences, as a supplement to its existing hardcore base on the streaming side.



ESPORTS' ADVANTAGES VS. SPORTS (CONT'D)

ESPORTS TRENDS ALSO ALIGN WITH USER-GENERATED AND BROADER ONLINE CONTENT TRENDS



DIGITAL CONSUMPTION IS DIFFERENT FOR THE GEN X POPULATION VERSUS MILLENIALS / GEN Z POPULATION

One of the seminal divergences between Gen X and millennials plus Gen Z demographics is that the millennial/Gen Z set spends an inordinate amount of time watching, playing, communicating and spending time on YouTube, Twitch, and other user-generated content channels



GAMING LENDS ITSELF WELL TO NEW DIGITAL CONTENT TRENDS

As the #2 vertical on YouTube (behind music) and the primary vertical on Twitch, gaming has emerged as a new community-based battleground toward which younger users are gravitating.

Esports is natively digital, and ties in nicely with these content trends.

Esports and gaming content are readily available and accessible across multiple platforms, whereas physical sports such as American Football have local blackouts on linear TV.



ADVERTISERS AND MEDIA COMPANIES NEED TO FIND WAYS TO CAPITALIZE ON THESE NEW DIGITAL CHANNELS

As more viewers and participants move to these digital channels, advertisers and media companies will feel a greater urgency to find new models and pathways to capitalize on this elusive audience, especially as some of the viewership numbers on traditional channels have decreased in recent years



ESPORTS' ADVANTAGES VS. SPORTS (CONT'D)

ESPORTS IS ACTUALLY ONE OF THE FEW TRULY GLOBAL SPORTING ACTIVITIES



MOST PHYSICAL SPORTS ARE STRONGEST IN ONE PARTICULAR COUNTRY

The NFL (American football) is dominant in North America, but is less prevalent internationally.

The NBA is strong in North America, with growth in Asia (thanks to Yao Ming and Jeremy Lin) as well as Latin America. Overall, however, it still pales in comparison to soccer in Europe.

The MLB (Major League Baseball) is strongest in North America, along with Latam, the Caribbean, and parts of Asia including Japan. Overall, however, it is not a truly global sport.

Tennis is popular throughout the world but does not have the scale in any individual country that some of these other sports do.

Sports such as rugby and cricket have huge followings, but are much more regionalized.



SOCCER IS THE ONE EXCEPTION

The only physical sport with a major audience in all countries is soccer



ESPORTS IS A GLOBAL PHENOMENON

Therefore, the only other sporting activity that can qualify as a truly global phenomenon is esports, where esports have become more mainstream in Asia (China, South Korea), Europe, and North America.

While esports is still in its relative infancy, it has shown a cultural resonance across all corners of the world in the early going.



ESPORTS' ADVANTAGES VS. SPORTS (CONT'D)

PLAYER COSTS AS A PERCENTAGE OF OVERALL OPERATING EXPENSES WILL LIKELY REMAIN LOWER THAN IN PHYSICAL PROFESSIONAL SPORTS, INDICATING BETTER PROFITABILITY FOR ESPORTS TEAM OWNERS



PLAYER CONTRACTS CAN MAKE UP AS MUCH AS HALF OF OPERATING EXPENSES IN PHYSICAL SPORTS

IDG channel checks indicate that for some of the major physical sports, player contracts can account for roughly 40-50% of total operating expenses for teams and leagues



PLAYER CONTRACTS MAKE UP A MUCH SMALLER PORTION OF OPERATING EXPENSES WITHIN ESPORTS

By contrast, the current esports landscape indicates that player contracts are only running at around 10% of total operating expenses. While IDG believes that player contract amounts do need to increase over time in order for esports to mature effectively, esports team owners do have more operating leverage in their model versus physical sports owners in established leagues.



THIS GAP IN PLAYER CONTRACT COSTS IS LIKELY TO REMAIN IN THE NEAR FUTURE

Even if this percentage goes up dramatically over time, it is likely that esports owners will still enjoy more operating leverage on player expenses than in physical sports for the following reasons:

- Although the average retirement ages between cyberathletes and physical athletes in most major sports are similar, there are many more examples in physical sports of athletes playing beyond the age of 30. In short, cyberathlete player longevity is generally much lower than in physical sports so the average lifetime payout of a cyberathlete will be much lower than that of a physical athlete.
- Physical sports athletes benefit from strong, lawyered-up players unions as well as an aggressive cadre of player agents, all of whom help with collective bargaining and extracting key concessions to players from the leagues. By contrast, the agency and players union aspects of the esports infrastructure are still at least a decade behind the curve of physical sports. Even in the North American LCS, where a new players association is being set up, IDG channel checks indicate that it will be a union, at least at the outset. Without these safeguards, player expenses in esports will likely be lower as a percentage of op ex vis-à-vis physical sports.



HOW IS ESPORTS OWNERSHIP DIFFERENT?

- In many ways, esports ownership will entail similar responsibilities to those of physical sports ownership
- However, there are some critical areas where there will be different considerations
 - Stadium/arena revenues are extremely lucrative for physical professional sports teams, and in many cases the owners of the physical sports teams also have partial ownership of the stadium/arena venue
 - ▲ By contrast, it is highly unlikely that esports owners will also have their own stadiums/arenas, since they will likely leverage the existing stadiums/arenas of current physical sports owners (Team Dignitas using the NBA's Philadelphia 76ers' facilities) or the stadiums/arenas currently being built by the IP holder/league operator (Activision Blizzard is building its own esports arena in Burbank for OWL)
 - In physical sports, many owners can focus all of their energy and resources on that particular team in one individual sport, since each of the major sports are in no danger of going extinct
 - ▲ It is possible that some of the major esports of today will lose popularity and could ultimately flame out in the long-term. As a result, many esports franchise owners are looking to own and operate teams in multiple esports leagues (for example, Echo Fox), as a way of diversifying their portfolio to hedge against any possible dissolution of one individual league.
 - In physical sports leagues, the leagues themselves are actually controlled by the majority owners of the franchises. In fact, the commissioners of each league are essentially employees of the owners, which gives physical sports owners a lot more control over league strategy.
 - ▲ By contrast in esports, the game publishers are bigger gatekeepers, as they do not work for the team owners and instead are held accountable to shareholders
 - ▲ Moreover, the publishers own the game IP, and in turn esports franchise owners lack the same type of control over esports leagues that physical sports owners have in physical sports leagues



CLOSING THE MONETIZATION GAP

- At the end of the day, aside from the difference in the sizes of the markets, there is a significant monetization gap between fans of physical sports and those of esports, and potential sponsors and investors are attracted to the esports market at the prospect of that gap being closed
- IDG believes a key crux that explains that gap is what was described on slide 61 as the balance between aspiration versus accessibility—physical sports tips in favor of aspiration, while esports tips in favor of accessibility
- Therefore, IDG believes the key to closing the monetization gap, assuming it can be done, is to tip esports' balance in favor of aspiration by building up esports players to be celebrities at the level of physical sports athletes





REGIONAL DEVELOPMENTS

SOUTH KOREA – A RICH ESPORTS ECOSYSTEM



- As demonstrated in Slide 22 (Quick History of Esports), South Korea was the early pioneer that helped to bring esports into the mainstream
 - In fact, South Korea was roughly a decade ahead of the rest of the world in terms of key ecosystem pieces:
 - A viable esports association (KeSPA)
 - A strong PC access point network via PC bangs (Internet gaming rooms)
 - Tournaments and events (World Cyber Games)
 - Dedicated television channels with 24/7 gaming and esports programming (OGN and the now-defunct MBC Game)
 - Sponsorship activity from some of South Korea's leading chaebols (powerful South Korean corporate conglomerates with longstanding influence in the country), with examples including the following companies:
 - ▲ Samsung
 - ▲ SK Group
 - ▲ Hyundai
 - ▲ LG
- 



SOUTH KOREA – THE WORLD’S ESPORTS PIONEER

- As the early leader in esports, esports has emerged as a national pastime in the Korean culture. Based on TV ratings, user engagement, and other metrics, many observers argue that esports is actually the top national sport in South Korea, outstripping soccer and baseball.
- According to TL Taylor, author of *Raising the Stakes*, early esports sponsors in the early 2000s claimed that their ROI was 500%. However, it was unclear how these corporate sponsors calculated that ROI and what the methodology was.
 - Additionally, the book indicated that SK Telecom, one of the major South Korean chaebols and the owner of SKT T1 (one of the top esports team franchises in the world), spent \$16.5 million in sponsorships and advertising across offline media, newspapers, magazines, and cable/satellite TV in 2008 on esports.
- In those early years pre-streaming/digital broadcasting, the scale of esports was still relatively small, even though its impact was felt strongly on a per capita basis
- Esports momentum appeared to be moving positively in South Korea, but several key **barriers emerged**, which in some ways have **limited South Korea to this day**



EARLY CHALLENGES TO BIGGER GROWTH

- Starting in 2008, South Korea's esports market began to face significant challenges
- As spelled out on Slide 22 (Quick History of Esports), the government passed a Shutdown Law to enact a curfew on online gaming to curb game addiction, the popularity of the longstanding original *StarCraft* began to wane, a major match-fixing scandal occurred among top players, and *League of Legends* began to overtake *StarCraft 2* in esports popularity.
- Moreover, there was constant tension between KeSPA (the Korea e-Sports Association) and Blizzard (the publisher/developer for *StarCraft*), as both parties argued over IP and marketing rights relative to the esports scene
- In 2012, MBC Game, one of the major esports TV broadcasting outlets, was discontinued and became a music channel. Not only did flagging ratings and contracting popularity hurt the channel, but the onset of Twitch and other web-based streaming services severely disrupted TV consumption patterns for esports.
- The World Cyber Games, a major tournament and event apparatus for South Korean esports, was also discontinued in early 2014 (although Korean games publisher Smilegate took over the WCG Trademark in March 2017)



EXPLAINING THE KOREAN PARADOX

Presently, the South Korean esports paradox still persists. In a country that is a worldwide leader in so many critical areas conducive to esports growth, it is remarkable that there are still some growth constraints at the same time.

UPSHOT

Boasts many of the world's best cyberathletes, across most major esports (*StarCraft*, *League of Legends*, *Overwatch*, and even *PUBG*). Strong up-and-coming local player talent to help fill new teams and new leagues over time.

Less physical sports competition. While soccer and baseball are big in South Korea, basketball, football, and other physical sports are less popular. And many argue that esports is #1.

IDG stakeholder interviews indicated that South Korea is best-in-class on training, player management, professional development, and coaching.

Beyond Twitch, YouTube, and AfreecaTV (a major local video streaming service), etc., South Korea also has a strong esports presence on linear TV (OGN).

Pro gamers are already regarded as celebrities in Korea.

CONSTRAINTS

Sponsorship revenues for some teams are actually down y/y, because some top teams have suffered performance-wise this year. There has been a talent-drain of late as many of Korea's best players have joined non-Korean teams to enjoy less stringent lifestyles.

Smaller sponsorship and strategic partnerships than in other countries, because the chaebols already own most of their own esports teams.

The chaebol-run esports teams (such as SKT T1) are likely leaving money on the table, as they earn a lot of money on streaming and TV media rights but have not been as aggressive on monetizing via merchandise and other revenue streams.

Most of the esports teams are run less as a monetization vehicle and more as a passive marketing vehicle (often with outsourced professional management) since they are often small parts of much larger corporate P&Ls.

Yet the Korean market is on track to be overtaken by progress in North America and China because the biggest esports titles in Korea are owned by foreign publishers, and publishers have the most to gain from franchising esports.



EUROPE – MAJOR CHALLENGES

WHILE NORTH AMERICA AND ASIA (LED BY CHINA AND SOUTH KOREA) HAVE BEEN THE MAJOR REGIONAL STALWARTS FOR ESPORTS, THE EUROPEAN MARKET HAS NOT GROWN AS STRONGLY AS ITS OTHER COUNTERPARTS, ALTHOUGH THIS COULD CHANGE OVER TIME

IDG'S CHANNEL CHECKS WITH INDUSTRY EXPERTS REVEALED SEVERAL CRITICAL REASONS FOR THIS UNDERPERFORMANCE TO-DATE:



EXTREMELY FRAGMENTED MEDIA MARKET

In order to popularize esports through different distribution channels, a Europe-wide approach will simply not work due to the wide variety of different languages, cultural norms, and localized players that must be broached

In each geography, esports teams and stakeholders must deal with different media companies, which can be extremely cumbersome

Sponsorship is currently the lifeblood of esports, but it is difficult for sponsors to reach beyond one or two markets within Europe, so the size of sponsorships for European teams tend to be smaller

Even in soccer, which is the world's #1 physical sport and is beloved throughout Europe, there are multiple leagues which reflect similar fragmentation vis-à-vis esports. For example, the two biggest European soccer clubs are part of two separate and distinct leagues. Manchester United is a part of the English Premier League, while Real Madrid is part of La Liga.

In the past, there have been Olympics-style esports competitions, pitting individual country versus individual country. However, those types of tournaments have only had moderate success.



DISPARITY IN ENGAGEMENT

There is a wide disparity in engagement, quality of the player base, and audience volume among different European countries. For example, even though the UK and France are two of the region's most populous countries, Sweden actually has a much bigger esports revenue share.



CHALLENGING ENVIRONMENT TO RAISE CAPITAL FOR ESPORTS

Some channel checks indicated that it is also harder to raise capital for esports enterprises in Europe, both due to regulatory requirements as well as the fragmented nature of the region



SOCCER DOMINATES IN EUROPE

Unlike South Korea, where esports reigns supreme as a top entertainment driver vis-à-vis physical sports, Europe is dominated by soccer and likely will remain so for the foreseeable future



DIGITAL GAMING AND STREAMING HAVE YET TO BECOME MAINSTREAM IN CERTAIN MARKETS

Although there are certain parts of Europe that are already very digital gaming-centric, such as Sweden, there are other parts of Europe, especially in Southern Europe (such as Spain and Italy), where digital gaming and spectating are growing fast but against a modest base. Until digital gaming and streaming behaviors become more mainstream, the overall growth trajectory for European esports will likely remain a bit more muted versus other regions where esports is already maturing.



REGIONAL COMPARISON

	NORTH AMERICA	EUROPE	SOUTH KOREA	CHINA
PLATFORM	PC, Console	PC, Console	PC	Mobile
MOST POPULAR ESPORTS TITLES	<i>League of Legends</i> CS:GO	CS:GO <i>League of Legends</i>	<i>League of Legends</i>	<i>Dota 2</i> <i>Honor of Kings</i> (aka <i>King of Glory</i>)
LEADING STREAMING SITES	Twitch	Twitch	Twitch AfreecaTV	Douyu Panda QQ
MOST POPULAR TOURNAMENTS	LCS The International	ESL One LCS	LCS	King Pro League
COLLEGIATE SCENE	Early stages, and growing slowly	Moderately developed but growing slowly	Moderately developed and growing quickly	Moderately developed and growing quickly
KEY INFLUENCING COMPANIES	Riot Activision Blizzard Valve	ESL European Gaming League	KeSPA Samsung CJ Group SK Telecom	Tencent



REGIONAL COMPARISON – KEY TAKEAWAYS

- The North American, European and South Korean esports markets share many similarities in terms of popular games and leading platform
 - South Korea's esports market is obviously the most advanced by far but also showing the slowest growth rate
- China's esports market tends to operate the most independently to the other regions, has the most unique nuances specific to its market, and appears to be on a growth trajectory of its own
- In North America and China, publishers are the key partners who have been pushing the esports market forward. In Europe, leagues are the largest single influences, and in South Korea, non-endemic conglomerates in partnership with KeSPA have helped to legitimize the market.





THE BUSINESS OF ESPORTS

Case Studies, Best Practices, and the Path Forward

MOVING FROM ESPORTS 1.0 TO 2.0

- In light of the key dynamics of esports relative to physical sports that were underpinned in the prior slides, the key theme is the transition from Esports 1.0 to Esports 2.0
- IDG maintains the thesis that there are many publishers who are making games with the hope that the game becomes an esports. But ultimately, the determination of which games become true esports versus those that don't is driven by the users themselves. The strength of the grassroots community of specific games is the ultimate driving factor in determining the esports prospects for a title.
- With that being said, while all esports must first grow via the grassroots with an authentic, enthusiastic community of gamers and fans, amateur tournaments, material prize pools, and the formation of minor league organizations to cultivate a player pipeline, the business aspects of esports will likely need to be developed by professional management and owners, as well as top-notch technology and media companies to scale appropriately
- Therefore, IDG has noted that the esports market is currently in a transition phase, as it grows beyond Esports 1.0 (organic grassroots development) to Esports 2.0 (the introduction of professional management, greater regulations, more established business practices and economics, and the heightened involvement of large media companies, bigger venue operators and physical professional sports ownership)
- In this transition from Esports 1.0 to 2.0, IDG believes that there is no longer a binary choice between organic, grassroots growth and professional management plus infrastructure. In IDG's view, the mainstream and sustainable growth of esports will rely on both movements, in order to reach greater success in the long-term.



ESPORTS 2.0: IDG'S POV

- Beyond the shift in esports industry fundamentals in moving from Esports 1.0 to 2.0, the greater meaning is the transition of esports from a marketing vehicle serving as a cost center, into a broader engagement and monetization vehicle that can become a profit center
- Even SK Telecom T1, one of the top teams in all of esports as a *League of Legends* powerhouse in South Korea, has not monetized anywhere near as well as it probably could. The goal for Esports 2.0 owners is to build a winning franchise like SK Telecom T1, but also build a stronger business model around it than SK Telecom has. Historically, SK Telecom has treated this esports property like a marketing vehicle, and less as a monetization vehicle. Esports 2.0 best practices directly address these disconnects.
- Ultimately, esports teams, players, and leagues will need greater professional management in order to improve monetization of the esports ecosystem. Physical sports teams are already adept at monetizing, but esports organizations need more time to ramp up in this critical area of growth.

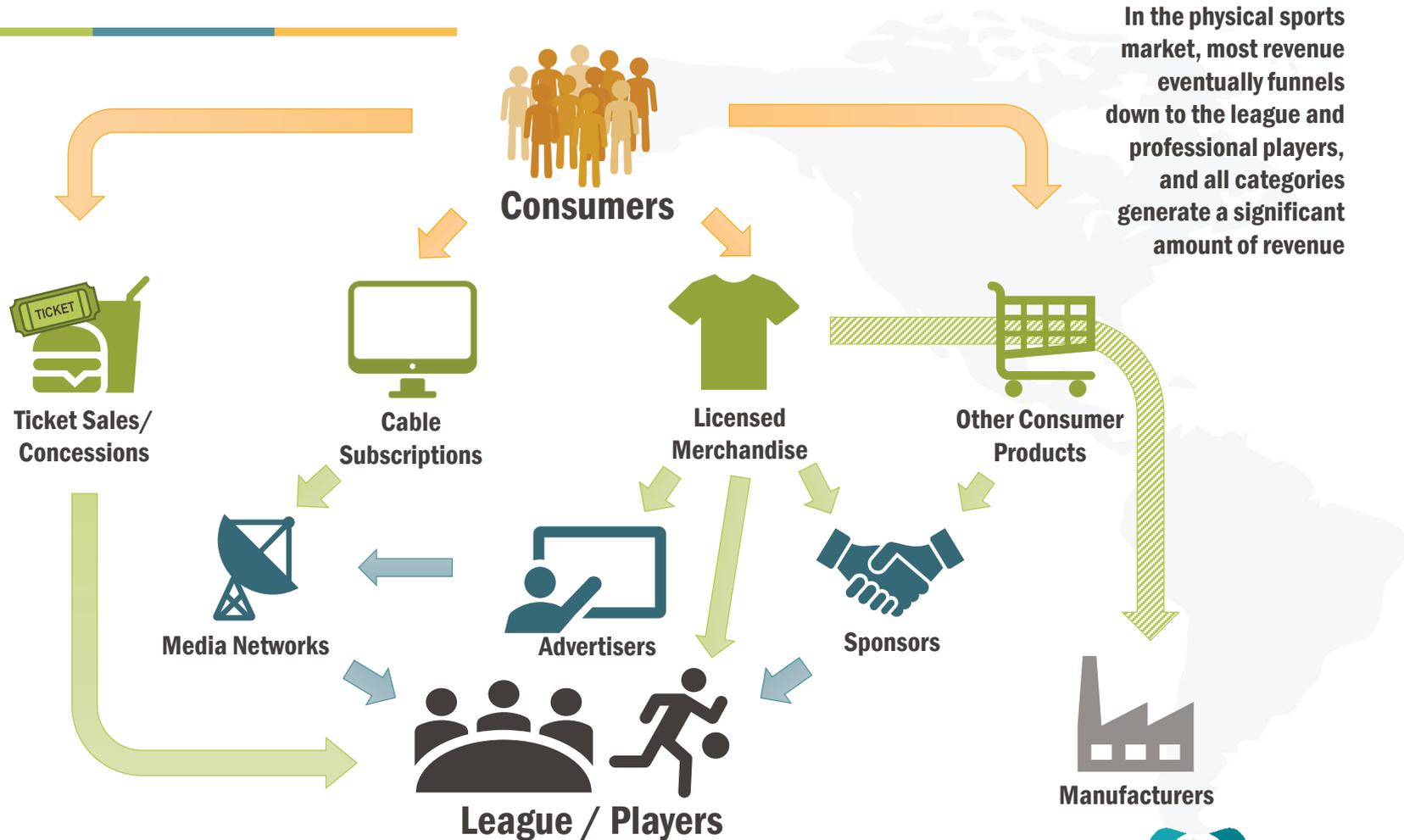


ESPORTS 2.0: IDG'S POV (CONT'D)

- While targeting high net worth franchise owners with high entry fees to participate in these leagues hurts the “democratization” of esports, it helps to ensure financial viability by funding the leagues with these entry fees at the outset
- Eliminating the promotion relegation system and giving franchise owners their rights in perpetuity will also give these owners greater freedom and flexibility to invest in growing their fan bases
- Publishers, leagues, and media networks alike will need to strike the tough balance between keeping esports more authentic and organically grassroots while also co-opting it with the right professional management and corporate participation. This balancing act will be a key factor in determining the ultimate success of esports.
- Overall, the esports business model is filled with complexity, and this chapter will delve into the key dynamics of the esports market from a financial perspective and highlighting the most important stakeholders within the value chain



PHYSICAL SPORTS MODEL



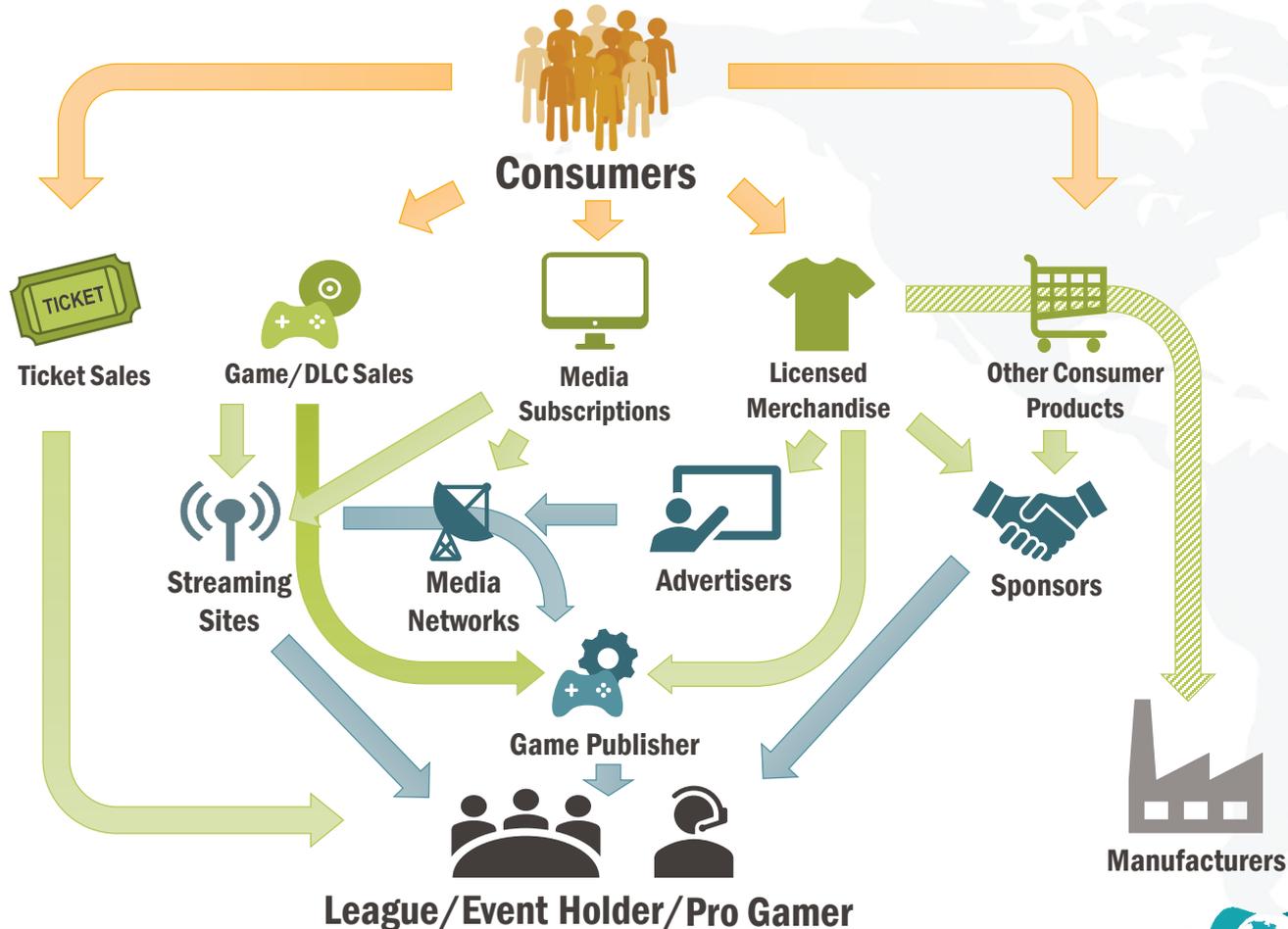
CURRENT ESPORTS MODEL

In the esports market, revenue is scattered across numerous parties, but the most significant revenue stream goes largely to the game publisher



IDEAL ESPORTS MODEL

To create a more sustainable revenue model, the revenue from consumers would need to have a “cleaner” model that eventually funnels revenue down to the leagues and pro gamers



CURRENT VS. IDEAL

A few key differences between the current esports model and the ideal one:

1 Addition of media subscriptions as a meaningful revenue stream

The ideal model sees the addition of this critical new revenue stream, which allows the esports venture to become a sustainable business for streaming sites, and possibly traditional network media as well. Currently, streaming sites and network media are relying primarily on sponsors and advertisers to fund the space.

2 No more prize pools

While prize pools were an important method of attracting pro gamers to the esports scene in the early period, in a mature esports market, prize pools would ideally go away as regulations around salary would ensure that all pro gamers, regardless of whether their teams were #1 or not, would receive an attractive income. The idea that teams need a monetary incentive to play their best is a fallacy; most professional athletes compete for personal fulfillment as well as public glory, more so than for financial gain.

3 Greater merchandise/ticket revenue

Whether it be tickets to in-person tournaments or e-tickets to virtual courtside seats, and whether it be actual physical merchandise or virtual merchandise, ticket sales and licensed merchandise need to become a greater source of revenue, as these items provide a more directly measurable ROI and could be critical to attracting and keeping endemic and non-endemic advertisers and sponsors alike in the esports space. One way to increase ticket sales would be by offering free tickets to committed fans or allowing fans to earn points to purchase tickets to tournaments, which would hopefully result in more ticket sales down the line.

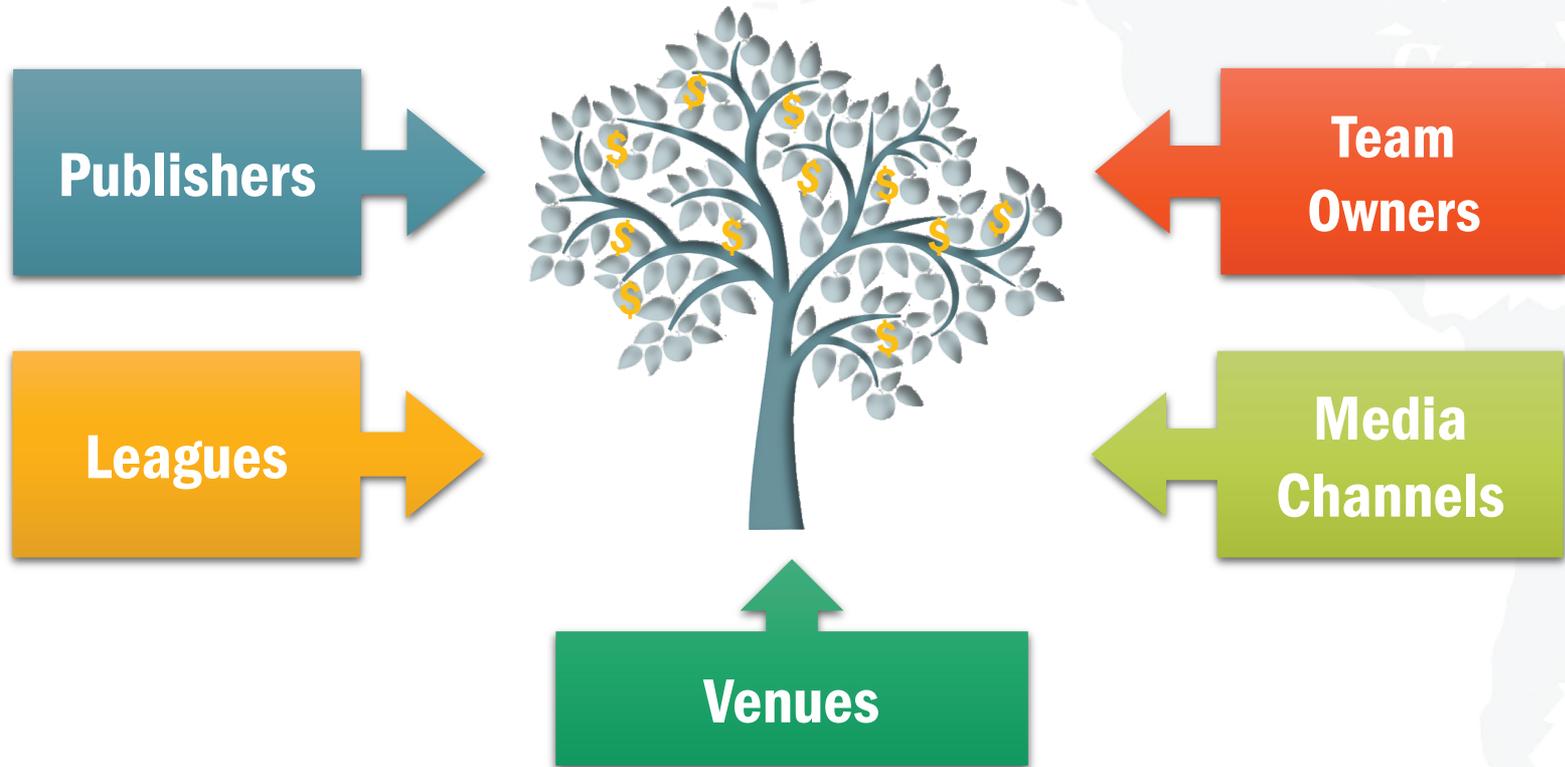
4 Consolidation of parties

In the current esports market, the league and event holder are sometimes two separate parties. In an ideal scenario, the league and event holder would be one and the same party (if tournaments eventually became solely digital), or the league would outsource tournaments to an event planning company (if tournaments remained physical). Regardless, the event holder would be in a financially viable position, whereas in the current market, event holders are often funded through sponsorships, which are not a reliable source of revenue.



HOW TO GET FROM THE CURRENT MODEL TO THE IDEAL?

The Esports market is a lucrative opportunity that must see maturation across numerous verticals to help reach its full potential



THOUGHTS ON CITY-BASED ESPORTS



CITY-BASED TEAMS COULD BE THE FUTURE OF ESPORTS.

WHY?



City-based is one of the most obvious ways to materially increase attendance at tournaments, which would lead to greater ancillary revenue from merchandise, etc. Greater sales of merchandise and other consumer products would convince more advertisers to target the esports spectating demographic, and greater advertiser buy-in is necessary to give streaming sites and cable networks a more meaningful revenue stream from esports.

City-based would significantly increase audience engagement as well as expand reach. Currently, teams have to appeal to a global audience, which requires a different and more intensive marketing strategy, than appealing to a more local audience. While the physical radius of a team's appeal would diminish with location-based esports, a team's reach across the fan spectrum would deepen.



THOUGHTS ON CITY-BASED ESPORTS (CONT'D)

THE NEGATIVE CASE: A FEW CAVEATS ON CITY-BASED ESPORTS

1. City-based will not happen overnight, no matter how much money is invested upfront to make a city-based franchise successful; it will have to grow organically
2. A game that already has a large audience base, like *League of Legends*, is the best prospect to successfully become a popular game with city-based teams
3. Another potential pathway to city-based esports for a game that doesn't have *League's* audience size is via starting at the collegiate level

IDG believes there is still the possibility of a scenario in which city-based teams do NOT become the de facto structure of most major leagues

Esports inhabits a digital universe and by nature is not tied down to physical locations, aside from major regional boundaries. The problem is that the *institution* of esports requires city-based to happen more than the community needs it. If the market were to find a way to bolster the revenue flow to key parties without establishing a city-based league structure, regional leagues may continue to be the dominant structure for esports.

While OWL has thrown in its cap for a city-based league, it's yet unclear if city-based esports will catch on for other leagues. Physical sports leagues adopt the city-centric model not only to help in building a local following for the team but also to gain government support for building stadiums. Earlier this year, Washington D.C. became the first major city to officially sponsor an esports team and is building an arena to host the WNBA and esports tournaments alike. It's unclear if other cities will feel compelled to get involved with esports, as competitive gaming may not be as well understood by government officials as it would be by private teams with no ties to a formal location.

Furthermore, due to its digital nature, digital spectating may become the norm, making all physical location-based marketing practices obsolete. New budding technologies like VR/AR/MR could feed into these trends. Virtual court-side seats and virtual team jerseys for their avatar to wear courtside might be the premium that esports spectators pay for rather than attending in-person tournaments.



WHAT PUBLISHERS ARE DOING

THE TOP 4 ESPORTS PUBLISHERS HAVE DIFFERENT APPROACHES TO THE MARKET

#1



Support pro gamers
Make esports a sustainable career choice

#2



Generate big money
Make esports too lucrative to ignore

#3



If you build it, they will come

#4



Anything you can do, I can do better,
stronger, faster



THE RIOT GAMES APPROACH



SUPPORT PRO GAMERS, MAKE ESPORTS A SUSTAINABLE CAREER CHOICE



RIOT WAITED TO LAUNCH ITSELF INTO THE ESPORTS SCENE

In comparison to publishers who today are releasing games in the hopes of birthing a massive esports phenomenon, Riot Games was fairly late to lending its financial support to sustaining *League of Legends*' esports ecosystem. This is understandable—with *LoL* sitting pretty as the biggest esports title in the market by a factor of multiples, there was no need for Riot to invest in growing the game even further when the community was doing the work for them.



RIOT PUT STRONG SUPPORT BEHIND PRO GAMERS FOLLOWING SLOWING GROWTH OF LOL

But by 2015, *LoL*'s revenue growth began to slow as other esports titles began to capture more user timeshare. It's no coincidence that by mid-2016, Riot Games began singing a very different tune, with Riot co-founder Marc Merrill promising to support the publishers' own biggest supporters—*LoL* pro gamers.



IN SEPTEMBER 2016, RIOT MADE ANNOUNCEMENTS REGARDING PRIZE POOLS AND REVENUE SHARE

Thus, in September 2016, Riot Games announced a revenue share plan that would increase prize pools in some of its pro league tournaments. The company also expressed an intent to ensure that teams receive a minimum threshold of revenue—one that would make a career as an *LoL* pro gamer a sustainable one.



MORE RECENT EFFORTS WERE UNDERTAKEN TO ENHANCE THE NA LCS

More recently, Riot Games outlined plans that will attempt to elevate the North America *League of Legends* Championship Series (NA LCS) to the ranks of established physical sports leagues. These plans include:

- The establishment of a franchise framework for the NA LCS with a \$10 million buy-in for teams
- The establishment of an Academy League to help teams cultivate new players
- A minimum salary guarantee for professional players
- An expanded revenue share structure where involving players, teams and Riot would each receive roughly 1/3 of league revenue
- Plans to help establish an independent Players Association



RIOT IS ATTEMPTING TO LESSEN THE FINANCIAL BURDEN ON TEAMS WHO PARTAKE IN THE LCS

Altogether, Riot's plans emphasize minimizing short-term risk for teams and players so they feel safer making a long-term commitment to their careers as pro gamers. The \$10 million buy-in is large enough that it signals to all parties that teams who buy a franchise are making a serious investment in the future of the league, but only ½ of the amount is due upfront, lessening some of the burden on team owners. Riot also plans to support teams who need additional financial assistance by putting them in touch with investors interested in the esports space.



THE RIOT GAMES APPROACH – IDG’S TAKEAWAY



RIOT COOPERATED WITH TEAM OWNERS TO FORM THE STRUCTURE OF THE LEAGUE

Riot's approach has many merits, and it should make team owners as well as players pretty happy. In fact, Riot worked directly with team owners, such as Andy Dinh (owner of Team SoloMid), to form the structure of the league. Dinh reported giving Riot access to TSM's financials in order to help the publisher fully understand the logistics of operating an esports team.

This, more than any concrete feature of the league itself, is one of the most promising aspects of Riot's approach—Riot's willingness to work with teams and players, and its acknowledgement that the league is a work-in-progress that will need to be continually improved upon to the satisfaction of multiple parties.



RIOT SHOULD MAKE NOTE OF THE COMMUNITY'S INFLUENCE WITHIN ESPORTS

There was, however, one additional very important party that IDG feels was left out of the development of the league structure, and that was *League of Legend's* community and fanbase. Teams and pro gamers are important, but spectators are arguably the most important party within the esports ecosystem. Some members of the community have already been reporting that as LCS has grown larger, it has been increasingly losing touch with its community and beginning to feel more "corporate."



WINNING TEAMS HOLD A DISPROPORTIONATE ADVANTAGE WITHIN THE LCS

However, the single biggest flaw that IDG sees in the structure of NA LCS is the fact that the league will still award larger financial prizes to winning teams to reward them for their excellency as well as to invest in further training, infrastructure costs, etc. Riot claimed their motivation behind this was to incentivize teams to win. The problem is that if only winning teams are rewarded with extra funds to invest back into their teams' improvement, it could result in a scenario in which the same team wins year after year due to their financial competitive advantage.



PHYSICAL SPORTS LEAGUES HAVE LEVERAGED SPECIFIC STRATEGIES TO AVOID THE ENTRENCHED WINNER SCENARIO

In contrast, physical sports leagues have salary caps in place and grant first draft picks to the weakest teams in the league specifically to avoid the entrenched winner scenario. At the end of the day, Riot's logic appears flawed. Once financial needs are sufficiently met, teams shouldn't require financial incentives to want to be champions.



SUMMARY: PROS & CONS OF RIOT'S APPROACH



PROS

League structure thoughtfully designed to benefit not only publisher, but also team owners and pro gamers

Riot dedicated to continual improvements to league as needed, with an emphasis on open communication



CONS

Winning teams will still earn more than non-winning teams

“Sterilizes” *League of Legends*, makes it feel more corporate and less in touch with the community



THE VALVE APPROACH

VALVE GENERATE BIG MONEY, MAKE ESPORTS TOO LUCRATIVE TO IGNORE



VALVE HAS CONTINUOUSLY SET RECORDS FOR PRIZE POOLS FOR ITS TOURNAMENT, THE INTERNATIONAL

Valve has set the gold standard when it comes to crowdfunding prize pools for esports tournaments with sales of the Compendium for The International. Every year, the total prize pool for The International has set a new record beyond the prior year's record-setting figure.



VALVE'S ASTUTE ECOMMERCE STRATEGIES CAN BE CREDITED FOR THE INTERNATIONAL'S SUCCESS

But how much of The International's enormous and growing prize pools are a function of *Dota 2*'s popularity as an esports, and how much of it is a function of Valve's years of hard-earned know-how when it comes to driving digital sales?

Case in point: Valve reports almost every year that Steam sales are growing, doubling, etc. But the company has long since been leveraging shrewd ecommerce strategies to achieve these yearly goals (not to mention the occasional obfuscation through vague verbiage, such as reporting that "sales grew 2x" while omitting that it was volume, not revenue, that doubled). Valve went from hosting the well-timed Steam Sales to experimenting with gamifying sales—to smashing success.



THE COMPENDIUM HAS EVOLVED OVER TIME TO FUNCTION AS A TOOL TO DRIVE TOURNAMENT ENGAGEMENT

A look at how Compendium's sales have evolved over time clearly shows that similar mechanics are being leveraged to drive the record-setting prize pools every year. The original 2013 Compendium was a pretty simple interactive booklet that helped fans of The International keep up-to-date with the tournament.

But Valve quickly turned ownership of the Compendium into a mini-game in and of itself. What was once a one-time purchase item soon began rewarding participants with an ever-growing number of exclusive in-game items and tournament tickets for each level of expenditure they made toward the Compendium prize pool.

Moreover, the Compendium's in-game rewards worked multiple functions. They were not only carefully designed to not cannibalize regular in-game purchases from non-Compendium buyers, they actually worked to drive even greater engagement and more in-game purchases down the road. On top of that, many of the in-game items were user-generated, so users did the work for Valve—genius! And the tournament tickets included with purchase of the Compendium resulted in future purchases of merchandise and other items at the tournament, of which Valve received a licensing royalty.

Ultimately, purchasers of the Compendium were not only motivated to spend more, and to encourage their friends to spend more, they became more vested in the tournaments as a result, making it easier for them to rationalize spending even more. Considering the demographic that makes up the esports-spectating audience tends to have a natural affinity for competition, gambling and collecting, by adding in these gamified features, it was an achievable feat to take the prize pool from \$2.8M in 2013 to over \$24M in 2017.



THE VALVE APPROACH – IDG’S TAKEAWAY



CS:GO LENDS ITSELF TO SPECTATOR VIEWING

While *Dota 2* tends to be more headline-grabbing thanks to its high-profile The International (TI) tournament, experts on the ground agree Valve’s *Counter-Strike: Global Offensive* (CS:GO) is the real #2 esports game behind *League of Legends*. CS:GO has the benefit of being a more entertaining and easier-to-understand spectator sport, it boasts a stronger in-game economy that has given birth to a strong fantasy/betting scene, and its pro gamers have more colorful personalities that have attracted strong fan loyalty. These days, *Dota 2* is popular primarily only in China, whereas CS:GO is more “global”.



THE LARGE SIZE OF THE INTERNATIONAL’S PRIZE POOL COULD HAVE HINDERED DOTA 2’S ESPORTS POTENTIAL

Ironically, it is Valve’s own crowdfunding stratagem that may have inadvertently hurt *Dota 2*’s potential as an esports. The problem when a prize pool gets so monstrous is that it makes all other tournaments for that particular game less interesting in comparison—for both pro gamers and spectators. As a result, the esports community has begun to focus increasingly on TI, and teams that have not made the cut have felt less *raison d’être*, effectively shrinking *Dota 2*’s esports scene even further. This is yet another reason why IDG believes prize pools need to be phased out for esports to reach a mature state.



THE NEGATIVE EFFECTS OF VALVE’S CROWDFUNDING EFFORTS ON THE ESPORTS SCENE

Ultimately, Valve is a bit of a black box. It’s hard to know what the company’s intentions and end goals are when it comes to esports. Does the publisher realize that its crowdfunding efforts inadvertently hurt the esports scene outside of TI? Does it care so long as the company rakes in 67% of the additional millions the crowdfunding generates? Does Valve understand its position of influence and the power it wields to help form the future of esports, and if it does, will the company leverage its power for the good of the entire ecosystem or does it only care about staying private and building monopolies?

There’s no doubt that Valve cares about making high-quality games, and the company will undoubtedly invest the crowdfunded millions toward further improvements to *Dota 2* but will those improvements be targeted toward making the game more fun to play... or toward making *Dota 2* a stronger esports title?



PROS & CONS OF VALVE'S APPROACH



PROS

Results in immense prize pools

.....

Drives engagement among players, allows fans to feel involved with development of esports scene

.....

Drives revenue for publisher, allows Valve to further invest in improvements to games



CONS

Crowdfunding benefits only a few parties—the publisher first and top teams second

.....

Valve doesn't seem interested in using crowdfunded revenue to legitimize esports for its games

.....

The International's dominance is stifling the rest of *Dota 2's* esports scene



THE BLIZZARD APPROACH

BLIZZARD IF YOU BUILD IT, THEY WILL COME... BUT WILL THEY?



BLIZZARD MADE ANNOUNCEMENTS ABOUT THE OVERWATCH LEAGUE DURING THE 2016 BLIZZCON

At the 2016 BlizzCon, Blizzard unveiled its plan for a professional *Overwatch* League (OWL), which would implement a location-based franchise model for the North American market only. Blizzard laid out the following details:

- The initial season would be prefaced by a “combine” during which teams can scout, test and sign new players
- Pro gamers would be guaranteed a salary and benefits
- Both teams and players would have a revenue share benefit with the overall league, but not until 2021
- Each team would represent a major city, and once a city franchise has been purchased, that team would be guaranteed a spot in the league indefinitely, regardless of its prior year’s performance
- Exact prices weren’t announced, but franchises would have to be bought through a bidding process, which means more desirable cities will likely command larger price tags



BLIZZARD HAS FACED CRITICISM REGARDING SOME OF ITS CHOICES REGARDING THE OVERWATCH LEAGUE

While not part of the official announcement, it’s been clear that Blizzard is hoping physical sports team owners and other non-endemic investors would make up a significant portion of the OWL’s team owners.

Blizzard faced significant criticism following the unveiling of the OWL, especially as team after team disbanded their *Overwatch* division following the OWL announcement. In Q3 2017, Blizzard made the following announcements:

- 9 teams were unveiled across the US, Asia and Europe; 5 of the team owners were non-endemic
- More teams will be unveiled as the year progresses, with OWL’s first season set to begin by the end of 2017
- While not explicitly stated when revenue sharing would begin, Blizzard did confirm teams would receive a share of revenue from advertising, ticket sales and streaming deals, etc.
- Teams would be licensed to organize 5 amateur tournaments in their respective cities per year
- In the first year, while esports arenas are being built in each of the franchise cities, all matches would take place in Los Angeles, California on Thursdays, Fridays and Saturdays

The timing of these latest announcements came as pessimism around OWL was beginning to reach a fever pitch, as Blizzard had been keeping a tight wrap on any new details pertaining to the league, which only served to fuel rumors of concern. At the same time, Blizzard’s choice of removing the threat of relegation has been appreciated by participating teams.



THE BLIZZARD APPROACH – IDG’S TAKEAWAY



BLIZZARD LEARNED FROM RIOT’S PAST EXPERIENCES WITH THE LCS

Blizzard’s approach to its *Overwatch* League (OWL) is unfolding not too differently from Riot’s plans for the LCS, which is probably not a coincidence. After the unfortunate fallout of Blizzard’s initial announcement (*Overwatch* teams began dropping like flies, as rumors of exorbitantly high franchise fees began to swirl), Blizzard probably knew it was time for a course correction and decided to take a few pages out of Riot’s book, revealing details on team revenue share and amateur talent cultivation, which were notably lacking in their original announcement. The removal of promotion relegation also provides stability. There will probably continue to be mutual learnings between Riot and Blizzard as the two companies hammer out the best format for esports leagues.



THE JURY IS STILL OUT ON WHETHER *OVERWATCH* CAN BECOME A TOP ESPORTS TITLE

Although the lack of details on team rosters might keep fans’ enthusiasm somewhat muted, Blizzard’s latest announcement could reverse the stifling effect its original announcement had on the fledgling *Overwatch* esports scene. The league structure also aims to create a profit center versus a cost center. However, several key issues remain.

The biggest issue is, while OWL could indeed become the gold standard for esports, a key risk factor is that despite the game’s initial popularity, whether or not *Overwatch* has what it takes to be a true esport hasn’t even been definitively determined by the esports community yet. Fans complain that the game is still not balanced and, while fun, it is not enjoyable to spectate. As a result, *Overwatch* has many players but not a large audience outside of South Korea and China—a leading reason why teams are dropping their *Overwatch* rosters. It would appear Blizzard has forgotten the golden rule of esports: *Companies don’t make a game an esport; the gamers make a game an esport*. Most likely, Blizzard’s motivation in announcing so early was in order to attract deep pockets and big brands early on, but the game itself needs to be improved for the esports community.



TERRITORY INEQUALITIES EXIST WITHIN THE OWL

Moreover, by specifying that OWL would start off for North America only in its original announcement, the burgeoning *Overwatch* pro-gaming community in Europe was basically snuffed out. European OW pro players were compelled to either move to the US or abandon the game altogether. Interestingly, in Blizzard’s latest announcement, two Asian cities made the initial list of franchises—one of them owned by NetEase, Blizzard’s partner in China on *Overwatch*. Shanghai and Seoul’s inclusion in the roster only served to whip up European esports fans into a greater frenzy about the lack of a European team, which might explain why a month later Activision announced that a London team had been purchased by Cloud9. The odd coupling (Cloud9 has no historical connection to London, the UK or Europe at all) might imply a lack of interest or product-market fit with existing European teams.



THE BLIZZARD APPROACH – IDG’S TAKEAWAY (CONT’D)



BLIZZARD’S BIDDING PROCESS MAY HAVE DRIVEN AWAY POTENTIAL OWL PARTICIPANTS

Another potential error was Blizzard’s choice to make its franchise ownership a bidding process. The logic in Blizzard’s decision makes sense—why name a set price and leave potential money on the table, especially when the ambitious nature of OWL will require significant upfront capital investments? But worse than the fact that it rubbed many esports fans the wrong way, the bidding process drove prices into the \$20 million range, which appears to have scared off endemic teams. Furthermore, the rationale for bidding for the city of one’s choice has been negated by the fact that Los Angeles ended up with two teams.



PHYSICAL SPORTS TEAMS WERE PRIORITIZED HIGHER THAN ENDEMIC ESPORTS TEAMS IN THE FORMATION OF THE OWL

Also discouraging for endemic teams is Blizzard’s obvious focus on bringing in physical sports teams owners and non-endemic investors into the mix from the very get-go. It might’ve been better for Blizzard to emphasize seeking the right team owner partners who share a vision and passion for shaping the OWL in the right way—as Riot has been doing. Physical sports team owners will indubitably bring their own value to the table when the league reaches a more mature stage—but to do so prematurely could cause more harm than good, as the cooperation of endemic team owners is just as important, if not more so, to getting the league off the ground successfully. Esports 2.0 is extremely important, but Esports 1.0 best practices must not be overlooked.



CAN BLIZZARD FILL STADIUMS BY POURING LARGE INVESTMENTS INTO THE OWL?

While IDG applauds Blizzard for being aggressive in investing heavily in a growth opportunity market, and the fact that esports is much stronger now than in 2008, it is possible that some of these moves are reminiscent of the now defunct Championship Gaming Series. The company is prioritizing building out all the infrastructure of a major league and assuming teams can be populated after the fact and spectators will naturally follow. MLG founder Mike Sepso’s interview with GamesIndustry.biz hints at this approach:

Sepso was asked if it’s possible for a regional esports team to fill a famous stadium like Barcelona’s Camp Nou. “I think it will be, for sure,” he replied. “[Filling the Camp Nou] is never going to happen unless somebody pushes it. Who better than Activision Blizzard to do that?”

To answer that rhetorical question... A few answers would include Riot, Valve, Tencent, Psyonix, ELEAGUE, Bluehole, etc. It’s possible that the OWL will recover from its initial setbacks, and perhaps once the league begins competitive play gamers and esports fans will follow, but with a game that has merely a fraction of *League*’s players and spectators, it might be a difficult venture in the initial stages, regardless of how much capital is invested into it.



PROS & CONS OF BLIZZARD'S APPROACH



PROS

Blizzard has deep pockets to support esports growth, with strong Esports 2.0 practices

Blizzard's brand equity allows it to attract non-endemic sponsors/investors, with the removal of promotion relegation a plus

Multiple games within its portfolio have gained meaningful esports followings



CONS

Overwatch weak as a spectator sport; announcement of league might be premature

Bidding process has driven franchise price too high, scared off potential teams

Launching league as city-based franchise will be difficult, and Esports 1.0 best practices must also be integrated more assertively



THE TENCENT APPROACH

Tencent ANYTHING YOU CAN DO, I CAN DO BETTER, STRONGER, FASTER



TENCENT'S *KING OF GLORY* MIMICKS RIOT'S *LEAGUE OF LEGENDS* IN SEVERAL WAYS

The same year it completed its acquisition of Riot Games, Tencent released insta-hit mobile game *King of Glory** in China. The game was essentially a clone of Riot's own hit, *League of Legends*, adapted with shrewd design tweaks for the mobile platform—such as a control scheme simplified for touchscreens, shorter battle times, and an auto-battling feature in the event of internet disconnection.



WECHAT/QQ HELPED *KING OF GLORY* BECOME ONE OF THE TOP GROSSING GAMES

Leveraging its massive WeChat/QQ userbases for virality, in less than two years, *King of Glory* had become the highest grossing game in the world, according to App Annie. Within that timeframe, the game already achieved a well-established King Pro League championships series with viewership rivaling the largest esports tournaments in the world, as well as a thriving collegiate scene, organized and overseen by Tencent itself.

- November 2015 – Tencent released *King of Glory* on Android/iOS in China
- September 2016 – The first season of King Pro League
- March 2017 – The second season of King Pro League attracted peak viewers exceeding 9 million



TENCENT HAS MADE STRATEGIC MOVES BY OBSERVING OTHER PUBLISHERS IN THE US

The evolution of *King of Glory*/King Pro League shows Tencent has been paying attention to what publishers are doing in the US. In 2017, Tencent introduced location-based ranking within *King of Glory*, which is likely a precursor to city-based teams and franchises.

Tencent's fostering of the collegiate scene also lays the groundwork for amateur location-based tournaments to eventually mature into a professional scene.

Tencent's latest news is that *King of Glory* will be soon coming to the Nintendo Switch.

**King of Glory* is also known as *Honor of Kings*, *Strike of Kings*, *Realm of Valor*, or *Arena of Valor*, depending on the territory and platform



THE TENCENT APPROACH – IDG’S TAKEAWAY



TENCENT LEARNS FROM OTHER COMPANIES AND IMPROVES UPON EXISTING PRODUCTS

There are many learnings to be gleaned from examining Tencent’s strategies, and the reason is because Tencent itself is a master at gleaning learnings from other companies—be they failures or successes. Tencent’s inquisitiveness about other companies’ practices and products is insatiable, and in spite of the company’s massive size, once it spies a market opportunity it executes with the agility of a start-up.

In addition, Tencent is not shy about replicating best practices from other companies, or even improving directly upon another competing product, if necessary. This includes not only competitors’ products, but even its own.



TENCENT ISN’T AFRAID TO LAUNCH A PRODUCT THAT MIGHT CANNIBALIZE ANOTHER OF ITS PRODUCTS

Which brings us to one of Tencent’s most daring but effective strategies—Tencent has no qualms about releasing a product that will cannibalize its own product IF it estimates that the overall market opportunity of those two products combined is greater than that of the single product alone. Very few companies have the courage to make this type of executive decision, but Tencent has time and again to great success. Examples include WeChat and QQ, *League of Legends* and *King of Glory*, and Tenpay/WeChat Pay/QQ Wallet. Essentially, instead of waiting for a competitor to release a competing product and steal market share, Tencent preemptively releases its own competing product and captures the market in totality.



THERE ARE A FEW OTHER BEST PRACTICES THAT TENCENT EMPLOYS

Due to the company’s inquisitive nature, Tencent understands its consumers and what they want extremely well.

Tencent has a strong sense of its own strengths as a company and designs around its areas of competency. For example, its massive QQ userbase is a key competitive advantage, so the company always designs its products around the idea of nurturing and promoting virality and social connection. Tencent’s first step is always to amass a large critical mass of users first, all else follows second.



PROS & CONS OF TENCENT'S APPROACH



PROS

Massive user reach

Strong user engagement

Deep financial pockets

Lightning-fast execution

Not afraid of competition

Track record of hits

Strong understanding of consumer base



CONS

Still at a relatively immature stage

Lacking in originality

King of Glory still lacks a major player base in the West



A FEW OTHER RISING STARS AND THEIR RESPECTIVE APPROACHES



Although not included in IDG's deep-dive analysis, as it is at an earlier stage in maturity, *Rocket League* nevertheless presents an interesting case study as well. Aside from the fact that the game is novel and addictively fun, *Rocket League*'s unique advantage is the fact that it is based off an existing physical sport with a large global fanbase,

and the game determines its winner by tallying points (versus the accomplishment of an open-ended objective in most other esports titles), so the game can convert non-core gamers to spectators more easily. Furthermore, *Rocket League* is the only esports title that is appropriate for all ages due to its lack of violence. Nevertheless, developer Psyonix has been focused on growing the esports community around *Rocket League* organically. The official *Rocket League* Championship Series, first launched in summer 2016 in partnership with Twitch, was fairly modest and only garnered peak viewership in the 80K range in the Season 1 Finals. But by Season 3, the final game saw peak viewership exceed 200K.



Bluehole's battle royale game released in March and sales of the game have been hockey-sticking upward. *PUBG* sold 8 million units in its first 5 months of sale (in Early Access) and then the publisher announced the game sold an additional 2 million in just 2 weeks. The game has not only overtaken *Dota 2*'s number of concurrent players on Steam, it is clearly cannibalizing the game as

Dota 2's user numbers have been steadily dropping since *PUBG*'s launch. In spite of this, the publisher is in no rush to turn the game into an esports. The game is still in Early Access, and while bugs haven't stopped incredible growth in playerbase, the developer's focus has to be on polishing gameplay before bringing it to the competitive scene. In its own words, the publisher is taking "baby steps," which include consulting other esports organizations on best practices.



SO WHICH IS THE BEST APPROACH?

IDG firmly believes that a ground-up approach is crucial to establish an esports game for the long-term. The multistep process to achieving a successful and sustainable esports franchise has traditionally focused on the players, first and foremost, but on spectators as a close second.

Steps 1. and 2. serve as proving grounds for a game and allows publishers to measure its potential in the context of esports

1.



BUILD PLAYER BASE

A large player base is the backbone of all esports games

Amateur gamers maintain interest in the spectating aspect of an esports title

2.



ESTABLISH COMPETITIVE BASE

Create gamer awareness during LAN events

Affirm within gaming community that competitive matches are suitable and entertaining for title

3.



ORGANIZE TOURNAMENTS

Work way up from smaller- to larger-scale tournaments

Work alongside event organizers to run tournaments at existing events by providing prize pool money and staff support

Avoid exclusivity in early going in order to grow as large a market as possible

4.



CREATE LEAGUE

Create official league with oversight by game publisher

League should have provisions for minimum player salaries, guaranteed team placement within league, players' rights association, revenue sharing, academy league to develop new talent

League would preferably be location-based and focus on regional establishment first before expanding globally

5.



GENERATE REVENUE

Increase sales of tickets, merchandise and other consumer products

Strike streaming rights deals with key media companies

Attract sponsors and advertising—both endemic and non-endemic

Maintain pro gamer community by offering monetary incentives to team owners including prize money and revenue splits



CAN ESPORTS BE REVERSE-ENGINEERED?



1. GARNER INVESTOR INTEREST

Gather investor interest in esports venture through a combination of:

- 1) Venture capital backing
- 2) Non-gaming companies interested in entering the space
- 3) Teams interested in the future revenue potential of the venture



2. PURCHASE AUDIENCE PARTICIPATION

Acquire interest from both the esports core audience and esports outsiders by purchasing exclusivity with high-profile teams and broadcasting rights



3. ORGANIZE TOURNAMENTS

Broadcast events to as large an audience as possible



4. MAINTAIN FOLLOWING

Retain high-profile teams with enticing revenue sharing opportunities

Academy teams can also be a way to bring in new talent and cultivate enthusiasm in the league

The market has yet to see a game successfully and sustainably establish itself as an esports with a top-down approach. Although raising a large amount of cash upfront might give parties the illusion of safety, IDG would argue that this approach in fact creates **significantly more risk** than growing an esports following organically. The reason is, it sets a high bar for generating

profit AND tacks on a tight deadline, all with no guarantee that the game will engender a strong-enough esports following to create a self-sustaining ecosystem. The power of the latter, in fact, is entirely within the hands of an uncontrollable and unpredictable element—consumers.



WHAT LEAGUES ARE DOING

THERE ARE COUNTLESS ESPORTS LEAGUES IN EXISTENCE AROUND THE GLOBE, AND AN EVEN GREATER NUMBER OF GRASSROOTS TOURNAMENTS

Services such as Battlefy seek to reduce friction points in setting up and accessing esports tournaments

Independent esports leagues, even those that have no affiliation with the publisher of a game, play a **critical role** within the esports ecosystem. These leagues:

1. Provide more touch points to potentially convert fans to esports, either as a player or as a fan
2. Provide more opportunities for esports fans to attend local tournaments in-person
3. Help create a bigger pond for pro gamers—the more tournaments to play in, the greater the number of pro gamers can be supported by the game
4. Create a supply pool of amateur gamers to eventually become pro gamers

In summary, leagues allow the esports scene to foster and flourish beyond what the publisher would be able to cultivate in “official” circuits alone, helping the market to reach critical mass



This is akin to Amazon’s official store and its Marketplace sellers. The online superstore couldn’t have become the behemoth it is today without the help of its Marketplace sellers in the early days.



Activision Blizzard is being restrictive in allowing outside leagues to host tournaments for *Overwatch*, which might hurt OWL’s potential rather than help it.

Valve has had a similar effect on the *Dota 2* esports scene due to The International’s exceedingly large prize pool.

Snuffing out the competition and shrinking the market reach of an esports game was a key factor that led to CGS’s ultimate demise.



WHAT TEAMS ARE DOING

- Teams have an important role to play in fostering the maturation of the esports market, with a plethora of responsibilities:
 - Marketing players and team brand, ensuring that the team resonates well with its fanbase and game community
 - Managing financial P&L of the team, which include gaining sponsors and invitations to tournaments, as well as overseeing the production of marketing content
 - Scouting and negotiating contracts with new players
 - Advancing players' in-game skill while overseeing physical and mental well-being of player
 - Ensuring players are financially secure, both in the present and in the future
 - Working with players' rights association to ensure players are treated fairly
 - Working with leagues to ensure players are obliging with league rules and regulations
- In the current market, some of the duties outlined above are already well-developed while other areas are still immature and in need of improvement



TURNING PRO GAMERS INTO CELEBRITIES – PART 1

- Beyond outlining an intense and strict practice regimen, responsible team owners also ensure their players eat healthy and get in a certain amount of physical exercise as well. Reaching peak physical condition ensures players play their very best.
- But in order for pro gamers to truly become “esports celebrities,” the care taken toward improving players’ physical appearance and marketability must be increased even more. Examples include:
 - Wardrobe/hairstyle consultants
 - Public speaking coaching
 - Media coaching – how to answer interview questions and interact with fans on social media
 - Player agents (as in physical sports) that not only negotiate contracts with team owners, but also with endorsers that are symbiotic with the player’s image
 - Hiring brand marketing experts to help raise the media profiles of esports players
 - ▲ A cautionary word on hiring external brand managers: It is absolutely essential that external companies understand the individual esports title and its community inside-and-out as fans are sensitive to marketing approaches that do not feel authentic



PRO GAMER SALARIES

- Pro gamer salaries have moved in-step with the increase in the aforementioned supplemental costs
- Sustaining and growing revenue for all participants—including publishers, sponsors and team owners—in the esports space is critical to the long-term viability of esports, but the treadmill would stop most abruptly without pro gamers and their deep and continued commitment to the space
- While \$4-\$6K per month (excluding income from merchandising deals and prize pool money) was representative of a top pro gamer's salary until recently, it is not uncommon to now see salaries that reach \$7-\$10K per month for gamers who compete in world events. With the influx of physical sports behemoths into the esports sphere, the current ceiling can hit as much as \$15K per month.
- Along with increased salaries, physical sports organizations breaking into the scene have begun to bring in longer-term contracts for pro players
 - Even year-long contracts were fairly uncommon for pro gamers in the past
 - However, 3-5 year contracts are now being offered to pro gamers by professional sports teams in certain instances
- However, these inflated salaries and contract lengths are precipitating a breakdown of the current esports structure
 - A power struggle is happening between smaller endemic esports teams and professional sports teams as the former are unable to compete with the large budgets of physical sports brands
 - While 3-5 year contracts are common in the physical sports sphere, the lengthier contracts aren't necessarily reflective of an esports space that is constantly revolving – It is difficult to predict where *CS:GO*, *LoL* or *Overwatch* will be in 5 year's time

The growth in player salaries is a necessary precursor to doing away with prize pools, which is necessary for a game to reach a mature stage as an esports



WHAT VENUE OPERATORS ARE DOING

- There are many invested parties who believe the future of esports is dependent on esports tournaments becoming more easily accessible to a greater number of fans. This entails increasing the number of venues that can stage and broadcast tournaments, as well as house a large number of spectators.
- This school of thought has driven a growing business for dedicated esports venues. A handful of companies are developing venues for large-scale events, including:
 - Allied Esports, a joint venture between Ourgame International, KongZhong and iRena, owns a network of esports venues in North America, Europe and China
 - Esports Arena also has several venues in Orange County, Oakland and North America, and is working on a line of trucks that can convert automatically into a full esports stage and broadcasting studio
 - The two companies have also partnered with the Luxor Hotel and Casino to bring a dedicated esports venue to Las Vegas in 2018, the first permanent esports venue for the city that could hold the key to being a major esports destination
- Esports venues are also being driven to more local stops for amateur players as retailers and arcade owners look for new growth areas
 - GameStop held tournaments for the *Injustice 2* World Championship at several of their stores
 - As its UK retail business has slowed down, GAME opened a number of Belong esports arenas for local customers to play competitive titles
 - Tournament organizer Oomba acquired GameWorks, which has seven arcades in the US that Oomba aims to expand into esports arenas

Pop-up venues, like the line of trucks Esports Arena is working on, may be one of the most low-risk types of esports venues, as they are versatile and mobile



WHAT TRADITIONAL MEDIA IS DOING

- Traditional networks possess a core competency that most live streaming networks currently do not have yet—the know-how on turning a match with relatively low actual “action” (players clicking mice while sitting in front of screens) into an entertaining showcase that can draw in viewers who are not completely versed in a particular game’s intricacies
 - Esports experts agree that content that is curated around narratives tend to convert more users and engender higher engagement than simple livestreams—however, engagement is not as high as seen on livestreams with interactivity between the player and viewers
- Traditional networks have been trying to leverage their expertise in creating spectacles to convert new viewers to esports, but many have found this to be an uphill battle
- In addition to trying to funnel users onto their linear broadcast channels, traditional networks should beef up their online streaming capabilities and leverage their high-quality entertainment content-making expertise to differentiate their broadcasts from those of livestreaming sites

Broadcasting can still serve a diversification purpose, in helping to broaden out the audience base while educating the mass-market on esports as esports penetrates the mainstream.

By playing to their strengths, traditional networks can differentiate themselves while also competing against livestreaming competitors on their turf.



TURNING PRO GAMERS INTO CELEBRITIES – PART 2

- Premium media channels also have an additional role to play in the maturation of the esports market
- One of the key steps necessary to grow Esports 1.0 to Esports 2.0 is to raise esports players closer to the level of celebrity that physical sports athletes enjoy
 - By giving esports players a “larger than life” persona, spectators of esports will eventually go from attempting to emulate their heroes by learning their tricks/strategies, to emulating their heroes by purchasing their merchandise, as consumers currently do with their favorite sports teams, musical artists, etc.
- When an esports player is frequently featured streaming from a home-like environment and also interacting regularly with spectators while doing so, the easy accessibility of the player hinders their ability to grow their stardom

While streaming has been and will continue to be a critical component to the growth of esports' reach, the end goal should be for the very best esports players to eventually limit their accessibility on free livestreams and be featured more exclusively on premium channels, whether that be cable networks or streaming sites



STEPS FOR ESPORTS GROWTH: IN SUMMARY

ESPORTS
1.0

MASS MARKET
Develop a hit esports title with more mass market reach

FANS
Evangelize more fans to esports

NARRATIVE-BASED CONTENT
Media and brand marketing companies help create narrative-based entertainment content that makes professional esports players more mythological like professional physical sports players

BEST PRACTICES
Develop industry-wide best practices around a franchise-based league model

RULES & REGULATIONS
Establish more rules and regulations around leagues and players' rights, salaries, etc.

LIFESPAN OF ESPORT PLAYERS
Figure out how to either extend the lifespan of an esports professional beyond 24 years of age, or reconcile the logistical hurdle of an esports players' peak years coinciding with the typical years of college attendance

LICENSING
Increase the number of stream licensing deals

MARKET REACH
Esports increases market reach

MONETIZATION
Esports increases monetization, selling more licensed merchandise and tournament tickets

LONGER CONTRACTS
Lengthen esports player contracts

INTEREST IN ESPORTS PROFESSION
Foster more interest in becoming a professional esports player

MEDIA REVENUE
Grow subscription-based and ad-based media revenue

ADVERTISING
Gain greater buy-in from non-endemic sponsors and advertisers

INCREASE IN REVENUE
Increase the amount of money funneling toward media, team owners and players

ESPORTS
2.0





THE FUTURE OF ESPORTS

WHERE WILL ESPORTS MAKE ITS OWN MARK?

- Esports is much more of a blank slate versus physical sports, and one of the great opportunities for esports is in leading the way on building out a digital-centric community and fan base. It is highly likely that physical sports will take a page out of the esports playbook on engaging digital audiences over time.
- IDG also anticipates that esports will help to lead the way on digital advertising, with physical sports leagues and physical media companies looking to esports firms to lay out best practices in engaging these younger audiences
- While physical athletes have only recently started to cultivate digital branding via social media, esports will likely function as a leading indicator for trends in the digital relationship between athletes and fans, since the public/private veil has been significantly pierced in the digital realm in recent years



ESPORTS IN THE OLYMPICS

- Dovetailing with the push for esports to be recognized as a “real” sport, there have also been efforts to have esports included in high-profile sporting events, such as the Olympics
 - The 2022 Asian Games will host a medal event for esports, highlighting a drive towards acceptance in the Asian market
 - The French government officially recognized esports as a sport in 2016 and has since been working to implement some regulatory framework for competitions
 - Paris is bidding to host the Olympics in 2024 and the team behind it is also pushing for esports to be recognized by the International Olympic Committee
 - Thomas Bach, the president of the International Olympic Committee, has publicly expressed concerns over allowing esports for violent video games into the event, noting that the committee was more interested in hosting competition for sports video games
- This raises valid questions as to how well esports could truly mesh with other physical sports
 - Gaming is different from physical sports in that the titles that are being played are owned by a private company, and the game’s rules and balancing are always subject to change
 - The Olympic Body likely doesn’t have the knowledge base to run competitive gaming events, let alone keep up with new titles emerging for esports as well as a private league could organize
- There is also a risk that by reaching too far too soon, esports could suffer another period of market burnout if it is added to the Olympic roster sooner than the market is ready for it, as happened after CGS went under

Esports being added to the Olympics would be more of a status symbol than a necessary requisite for the growth and maturation of the esports market.



VR SPECTATORSHIP FOR ESPORTS

- As both VR and esports are growing segments in the games industry that appeal to a more “hardcore” crowd, there is bound to be some overlap in their respective audiences. But as both audiences are currently fairly niche—VR much more so than esports—the audience size for VR esports spectators is expected to be limited in the near-term.
- While VR makes sense as a new way to make top-down gameplay more exciting to watch, it remains yet to be seen whether VR can enhance the experience of spectating a title that’s already in first or third-person mode
- *Dota 2* has implemented VR spectatorship for live and pre-recorded matches. The mode is showing promise as an immersive way to watch *Dota 2*’s complex gameplay, allowing spectators to travel around the map and choose what they want to watch.
- However, there is still significant room for improvement, such as adding professional commentary, a way to view the actual players (rather than just their avatars), and perhaps a way to sense the reactions of other spectating fans
 - SLIVER.tv, an esports broadcasting startup focused on VR, is also developing solutions to spectate *League of Legends* and *Counter-Strike: Global Offensive* matches in VR

While many interesting applications are emerging in the VR space, it is important to note that consumers won’t feel compelled to adopt and engage with VR unless there are unique and immersive experiences they can have in it that they can’t get anywhere else. Esports broadcasters will have to find new ways of bringing viewers into the matches with VR and feel as though they can engage with the action for the two segments to truly converge.



ESPORTS TITLE GROWTH

- The market for esports is currently very top-heavy and concentrated by heavyweight titles like *League of Legends* and *Counter-Strike: Global Offensive*, but the esports audience clearly has an appetite for new titles
 - *PUBG*'s rapid rise to popularity has reportedly been cannibalizing players from *Dota 2*. With the release of Epic Games' similar battle royale mode in its new game *Fortnite*, it will be interesting to see if *PUBG*'s growth trajectory changes direction
- Developers aiming to bring their titles to the esports market should be cautioned that, on top of contending with entrenched games with massive playerbases and low barriers to entry on one side, on the other side, they will need to defend their market positions against game clones



PHYSICAL SPORTS-BASED ESPORTS

- IDG expects to see more publishers attempt to turn games based on physical sports into esports titles. A few ventures that are already in development:
 - The NBA and Take-Two Interactive are also forming their own NBA 2K eLeague off the back of the successful NBA 2K series
 - ▲ The league will start in 2018 and feature up to 30 teams, each of which will be owned and operated by a real NBA franchise
 - ▲ Being directly rooted with real NBA teams will likely help these new esports teams to more seamlessly acquire a fanbase, as the audience for this league will likely gravitate to esports teams already associated with their preferred traditional NBA team
 - ▲ The NBA is also likely viewing esports as an opportunity to drive better engagement with some of the league's younger and more digital content-focused audience
 - ▲ IDG believes that of all city-based esports leagues, the NBA 2K eLeague likely has the best chance of success with this model, since each NBA franchise already has a strong foothold in its local city-based market with an established fan base that can be tied into the affiliated eLeague team counterpart
 - EA has taken a more democratized approach to esports with FIFA and Madden, with a competitive gaming ecosystem that targets players of all ability levels
 - Milestone teamed up with Dorna Sport to create an esports championship series around *MotoGP 17*
- These titles can also appeal to a more mainstream audience because they don't focus on violent content or complex gameplay, and most viewers already know the rules of the game



PHYSICAL SPORTS-RELATED ESPORTS (CONT'D)

- However, IDG is not convinced that straight copies of physical sports are the strongest material for esports, for multiple reasons:
 - The core esports fanbase does not share much overlap with the core physical sports fanbase. Moreover, fans of sports-based games often play the game version of the sport because they are fans of the sport itself. When it comes to spectating the sport, it seems natural that they would prefer actual live matches over their digital counterparts.
 - Physical sports fans are accustomed to spectating on live linear television, whereas esports fans are accustomed to spectating online and via streams
 - A large part of what gives physical sports their wide appeal are professional athletes' aspirational stature. A sports-based esports player can only be as large a star as their real-life avatar counterpart is, and even then, the esports player's stardom will be magnitudes smaller—and an esports players' stardom is a large factor in a game reaching Esports 2.0 status. In other words, IDG does not feel sports-based esports can garner the mass appeal necessary to take things to the next level.
 - Most physical sports-based esports titles have the largest audience on consoles, so the audience for these titles are inherently more fragmented. Furthermore, the average console gaming user monetizes at a lower rate than the core PC gaming demographic.



PHYSICAL SPORTS-RELATED ESPORTS (CONT'D)

- On the other hand, esports games that feature a gamified version of an existing physical sport, or a game that is a hybrid of a physical sport and another gaming genre, have greater potential as esports titles
- Gamified versions of physical sports have the ability to cherry-pick the best features of physical sports and gaming to create a title that can really appeal to the masses
 - A key caveat to appealing to a mass market audience, however, is a limitation on the amount of violence
- In fact, IDG anticipates that the rocketing popularity of *Rocket League* will spur the development of more games that feature a gamified version of an existing physical sport, and that is a hybrid esports title that has the greatest potential to make it big as an esport



MOBILE ESPORTS

- Esports is inherently core... It's no coincidence that the more core the platform, the greater the size of the esports market on that platform
 - The reason for this correlation, at least in Western markets, may be explained by financial barriers to entry. The amount a consumer is willing to spend on their gaming hobby is a strong indication of their dedication to gaming, and a high-end PC gaming rig is more expensive than a gaming console, whereas mobile games are the most inexpensive of all when one factors in that most people own a smartphone anyway.
 - In Asia, however, mobile gamers are not as casual as their Western counterparts. This is partly because console gaming is not significant in these markets, but also because high-end PC penetration is very low. Therefore the entire gaming demographic, from the super casual to the ultra hardcore, co-exists on the mobile platform.
- Casual games simply do not possess the characteristics needed to draw a dedicated spectating audience (see slide 20-21 for what these characteristics are), and so IDG anticipates that mobile esports will remain niche in Western markets, but has the potential to become a prominent market in parts of Asia
- Companies such as Skillz and Discord are attempting to disrupt that paradigm, and could provide clues towards a more mobile-specific roadmap for success in esports however



WHAT A MATURE ESPORTS MARKET MAY LOOK LIKE

Gamer loyalty is too fickle to expect esports titles to have the same longevity as physical sports

Many esports investors envision a mature esports landscape will eventually feature a handful of games that stand the test of time and last for decades, as physical sports do. But IDG believes the nature of esports simply doesn't allow for this kind of future. Both the gaming medium and the esports market are constantly and rapidly evolving, and new would-be esports titles are being released at an increasingly faster rate. One need only look at *PUBG* to see how easily a new game can take the gaming community by storm, captivating the mindshare of core gamers and quickly siphoning away loyal players from one hit title to another.

The game itself is secondary

In the grand scheme of things, a killer esports game is not necessary for the esports market to reach maturity—there will always be fun competitive games being released, and copycatting has always been a hallmark of game development. When one formula works, and even when it doesn't, there will be companies waiting in the wings to improve upon it and produce an even better product.

Esports may only get as big as the appeal of the games at its core

In a seeming contradiction to the prediction above, the potential for esports will be dependent on a given game's ability to appeal to as large an audience as possible. A game within a niche genre, or a game that is only popular with gamers on a single console, is not going to have as much potential as an esports game that has more mass market appeal across multiple platforms.



WHAT A MATURE ESPORTS MARKET MAY LOOK LIKE (CONT'D)

A mature esports market needs established league practices and publishers experienced with managing league

Instead, IDG envisions that the esports landscape may continue to see titles that rise and fall after a period of 5-15 years, and the maturation that the esports market needs is in fact in publishers' ability to construct a sustainable esports ecosystem around hit titles quickly, in order to support a game's esports potential for as long as possible, and in the meanwhile, have the next hit title in development to take up the esports mantle when its predecessor's star begins to fade. In other words, it is the esports league structure and execution know-how that need to be perfected in order for the esports market to reach its peak potential.

Franchising is key ingredient to the maturation of esports but city-based franchises may not necessarily be

If the lifespan of an esports title averages only between 5-15 years, franchising can obviously not exist in the same format as it does in the physical sports world—and yet it will still be absolutely necessary in order to instill a level of stability and security into the career of professional gaming. This may not be that challenging of a balancing act, however, as the average career span of an esports professional is about 5 years anyway. On the other hand, IDG is not convinced that city-based teams is the only path to esports maturity.

